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SMALL BUSINESS PROBLEMS IN RURAL AMERICA

HEARING

BEFORE THE

SUBCOMMITTEE ON ENERGY, ENVIRONMENT, AND SAFETY ISSUES AFFECTING SMALL BUSINESS

OF THE

COMMITTEE ON SMALL BUSINESS
HOUSE OF REPRESENTATIVES

NINETY-EIGHTH CONGRESS

SECOND SESSION

WASHINGTON, DC, JULY 11, 1984

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SMALL BUSINESS PROBLEMS IN RURAL AMERICA

WEDNESDAY, JULY 11, 1984

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON ENERGY, ENVIRONMENT, AND
SAFETY ISSUES AFFECTING SMALL BUSINESS,
COMMITTEE ON SMALL BUSINESS,
Abilene, TX.

The subcommittee met, pursuant to notice, at 9 a.m., in the River Oaks room, Kiva Inn, Abilene, TX, Hon. Ike Skelton (chairman of the subcommittee) presiding.

OPENING STATEMENT OF CHAIRMAN SKELTON

Mr. SKELTON. The subcommittee will come to order. I will at this time make a few opening comments, then call upon Congressman Stenholm and, of course, later, Congressman Vandergriff, to open our hearing.

Needless to say, I'm pleased to be in Texas and hold this Small Business Committee hearing.

First off, I want to thank you for the courtesies extended me and my staff. A special thanks to Congressman Stenholm, who invited us to be here today. Yesterday, we had a similar hearing in Dallas, and what we learn today is of great importance to us on the Small Business Committee, particularly our subcommittee.

We have purposely left the agenda open so we can hear a broad cross section of thoughts of small business owners. We don't want to leave out any potential areas of interest.

We are here to receive testimony, to build a record for our committee and for the House of Representatives, to be used in dealing with upcoming legislation. What we learn today is so very important. The real America is right here in Abilene, TX, the real America is the America that Congressman Stenholm represents, that Congressman Vandergriff represents, that I represent back in Missouri.

There are good thoughts that come from the people that we represent, and we want to take those back with us. I do appreciate the courtesy and the opportunity to be with you, to accept this invitation today, and for our opening comments at this time, I ask your Congressman, and my good friend, Congressman Charles Stenholm.

OPENING STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. STENHOLM. Thank you, Mr. Chairman.

I ask that my statement be made a part of the record, and I would like to summarize it at this time.

Mr. SKELTON. Without objection, so ordered.

Mr. STENHOLM. I would like to express my appreciation to you, Ike, for taking time from a busy schedule in your own district to come to Texas, and to hold these hearings. I would also like to thank my good friend, Tom Vandergriff, from the 26th Congressional District, for being here today. We had an excellent hearing in Tom's district yesterday.

At yesterday's hearing we focused on export opportunities, and I think all of us on the Small Business Committee agree that there is a tremendous opportunity for small business in the export field. It's a relatively new field, and one we're going to have to learn to crawl in before we walk, and certainly before we run.

But, we know, based on testimony yesterday, and from what I'm hearing from small businesses, that there is an interest there, and it's going to be up to us to create a level playing field in order that we might be able to participate in that area.

Today, we are going to be focusing on really what small businesses of the 17th district would like to see the Small Business Committee focus in the 99th Congress. Our purpose in holding these hearings is manifold, but not the least of which is to try to come up with a small business agenda, and to find those areas in which small business people believe we in Government should be focusing our attention. Either undoing what we're doing that is wrong, or moving positively in areas that require adjustment and improvement.

That's the purpose of field hearings. It makes a lot more sense, and certainly it's less expensive in these times of high cost, for 3 Members of Congress, and a staff member to come here to Texas than it is for 25 witnesses, which we'll hear from today, to come to Washington to present this testimony. Everything we hear today will be a part of the record.

We will hear testimony and accept for the record longer statements. We will then look at those and try to come up with a small business agenda.

So, with that, Mr. Chairman, I again thank you and Tom for coming to Abilene. We thank the Abilene Chamber of Commerce for the many courtesies shown in helping us arrange these hearings today. We especially thank the witnesses, and also the Kiva Inn for making their facilities available to us today. Mr. Chairman, as you assume your new role as chairman of the Export Opportunities and Special Small Business Problems Subcommittee, I know you are very interested in today's testimony. I would like to make one last comment. When we talk about jobs, it's interesting that so often we overlook the major provider of jobs in the United States, small business people.

Most statistics show that 80 to 100 percent of all new jobs are created by small business men and women, going down to the bank and taking out a loan or taking out some of their savings, making an investment in whatever it is they are interested in, with the belief that they can make a profit.

When they pursue that profit level and that motive, jobs are created that provide an opportunity for people to have a job and to

have a home. Really, that's what it's all about and that's what we're here for.

Thank you for coming.

[Mr. Stenholm's prepared statement follows:]

PREPARED STATEMENT OF HON. CHARLES W. STENHOLM, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Let me begin by welcoming all of you to this Small Business Committee field hearing. We sincerely appreciate your interest in attending this hearing, and want to particularly thank those who will offer testimony today. I would also like to express my personal appreciation to my colleagues, the honorable Ike Skelton from the 4th District of Missouri, and the honorable Tom Vandergriff from the 26th District of Texas for taking time from their busy schedules to conduct this hearing. I have the privilege of serving with Ike and Tom on the Small Business Committee, where I have witnessed firsthand their obvious dedication and commitment to advancing the cause of the Small Business Community. I consider it an honor to serve with Ike and Tom in the U.S. House of Representatives, and I am pleased to have the opportunity to be a host to them here in the 17th District.

I would like to take this opportunity to thank the Abilene Chamber of Commerce for hosting a wonderful dinner yesterday evening, and for assisting our guests in getting around Abilene. I would also like to thank the folks here at the Kiva Inn for making this facility available for this hearing, and for many other courtesies they have extended to us.

The purpose of this field hearing is to gather information which can be used by Members of the Small Business Committee to form an agenda for the 99th Congress. We purposely did not choose to focus on any one particular area, but instead chose to provide an open forum in which individuals within the small business community and the Small Business Administration could express their concerns and ideas for improvement or change. We are fortunate today to have testimony concerning miscellaneous small business problems, energy industry concerns, SBA loan procedures, bankruptcy proceedings, the telephone access charge, and the Occupational Safety and Health Administration's proposed standards for grain handling facilities.

The subject which we will address today represents only a sampling of what is on the minds of people across the Nation. In Washington, D.C., our offices are flooded with communications from people who are concerned about the federal deficit, increasing interest rates, slowed economic growth, and an incomprehensible tax code. There is no question that deficit spending contributes to higher interest rates, increased trade deficits, decreased economic activity, and an irresponsible legacy of debt for our grandchildren and great grandchildren. Within this context it is imperative that we keep in mind that it is in the small business sector of our economy that the bulk of jobs are generated, and it is crucial that the relationship between government and business is cooperative and not adversarial. We look forward to having the testimony of those assembled today.

Mr. SKELTON. Thank you. Before I ask our friend, Congressman Vandergriff, to make his opening statement, let me add this, that I appreciate Congressman Stenholm, I appreciate Congressman Vandergriff, inviting us to come down to these two hearings. Everybody in Congress doesn't ask for this, and it shows a high level of interest on behalf of Congressman Stenholm and Congressman Vandergriff for them to want their people, the people that they represent, to be able to say something personally to Congress, and that's really what you're doing.

I especially am appreciative of the fact that both of you have asked me to come down and asked us to take this testimony. I think it speaks very well of Congressman Stenholm and Congressman Vandergriff for what they intend to do for the people that they represent.

Congressman Vandergriff.

OPENING STATEMENT OF HON. TOM J. VANDERGRIFF, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF TEXAS

Mr. VANDERGRIFF. Thank you, Mr. Chairman.

I think I can certainly speak for Congressman Stenholm when I quickly rejoin by saying that not every chairman would come, even if requested to do so. It is such eloquent testimony to your willingness to serve all the people in your capacity as a committee chairman that you would see fit to join us.

We had a useful hearing yesterday. We look forward to a very interesting session today. I am intrigued with the variety of subjects that we're going to address. I think we are going to leave Abilene much better prepared to discuss and move toward solutions for some of the problems affecting small business.

I'm particularly proud to be in Congressman Stenholm's district. I consider him one of the most eloquent and effective voices in Congress. He has achieved great recognition in just three short terms. So much so that he will soon join the ranks of subcommittee chairmen on our Small Business Subcommittee. This is very pleasing to me as a fellow Texan, but as also a true admirer of Congressman Stenholm's.

He and I have districts that adjoin. In fact, we share one county. We have had a joint down home meeting. I look forward to others. I look forward to his expanding leadership in the Congress. Nowhere do we have a more common interest perhaps than in the realm of small business.

With Chairman Skelton leading the way, and the very meaningful testimony I know we're going to hear today, I hope we can work to the benefit of small business generally.

Thank you very much, Mr. Chairman.

Mr. SKELTON. Let me run over the format with the audience, if I may very briefly, Congressman Stenholm and Congressman Vandergriff.

We'll do this by panels, and we are asking that the panel members who, of course, indicated their willingness to testify earlier, that they come forward when their panel is called, that their testimony be limited to 5 minutes. You may wish to submit the formal statement and then expound on your own, in a more summarized manner, if you wish.

Panel 1 will be miscellaneous small business problems; panel 2, Small Business Administration loan procedures; panel 3 will be on bankruptcy; panel 4 on energy. We'll break for a very quick lunch at 12:15 p.m. Panel 5 will be on OSHA; panel 6 will be the State office testimony; and panel 7 will be telephone access charges, which is very important to me. I'm on the Special Task Force of the Small Business Committee that deals with this very important problem, and then we will have an eighth panel which deals with the Small Business Institute.

Again, I will ask the witnesses to come forward, speak into the microphones. We are taking down every word that you say. Be sure to identify yourself, give your full name, your address, and your business or occupation, and then proceed with your 5 minutes.

After everyone has testified on the panel, then the three of us, and, of course, counsel, will have an opportunity to ask questions.

The first panel, panel 1, Maxwell Green, Borden Duffel, William Sutton, Raymond Jones, and Lex Shelby. If you gentlemen would come forward, please? If there are too many chairs, just push it down the side.

I will watch time carefully. I will try not to gavel you down. I will raise my gavel when you have about 10 seconds to go. So, keep an eye out.

I will go from my left to your right, and we will proceed with Mr. Green. Thank you very much for joining us, sir.

TESTIMONY OF MAXWELL D. GREEN, CERTIFIED PUBLIC ACCOUNTANT

Mr. GREEN. Good morning, Mr. Chairman. My name is Maxwell D. Green. I am a certified public accountant with my practice being in Big Spring, TX. My testimony has been submitted to you previously in length, but my main thing is the fact that small business does create all new jobs.

Mr. SKELTON. Let me interrupt you right there, Mr. Green. Without objection, we will enter your full testimony in the record. You may proceed.

Mr. GREEN. OK. Thank you, sir.

Now, this is actually a private undertaking. In other words, one of the things that Congress needs to do is tc start encouraging salaried individuals to quit their jobs and to go into business for themselves. This is where the new jobs are created from, and these new policies would create many thousands of additional jobs.

The current problem that the small business person is faced with is many and numerous. One of the problems is our high interest rate. In other words, you gentlemen are able to outbid the small businessman whenever you go into the money market, in order to borrow money.

One of the typical remarks that many bankers have told me during this period of time, Green, we can loan money to the Federal Government for 10 percent, so we're going to need 12 percent or 13 percent from you. This drives me out of the market, and I'm unable to make a profit after I pay this 12 to 13 percent. Another problem, our welfare programs. Really, it's quite amazing to me whenever I get to looking at this because I have discovered that it does pay to be a deadbeat. One of the things is when you go down and if the person is very astute, he can make more money by being on the welfare rolls than what he can by minimum wage.

This takes people out of the labor market and we're unable to hire people to work at a minimum wage or people that are willing to work.

High taxes are a great big problem. We must make a profit in order to pay back the money that we have borrowed. By the time that we pay back our notes or we meet our monthly note payments, by the time we pay our Federal income taxes and our other taxes, we no longer have enough money left over in order to live. So, we need to restructure our tax laws to where we can either get front-end-loaded chargeoffs or some other way to enable us to finance our businesses as we go along.

Regarding reports, every time we turn around there is just all sorts of reports that we either have to file with the State or Federal Government. We have unemployment taxes that we are faced with. We have workmen's compensation insurance. A new businessman that comes into the office and hears me talk about these things he says, I am glad that I came here and talked to you first because I didn't know that my overhead was going to have to bear all these additional expenses.

This, in turn, drives the price of the product up that we must charge. The biggest thing of all, if you would adopt new policies or policies different from what you have been following over the past few years. This will create a multitude of new jobs and the nicest part of all about it is the fact that these individuals that are going into business, they are using their own capital and you gentlemen would not even be concerned, would not have to worry about raising tax money in order to support a famous program like this, a fabulous program like this.

Gentlemen, that concludes my brief remarks, and I appreciate your kind attention.

[Mr. Green's prepared statement follows:]

PREPARED STATEMENT OF MAXWELL D. GREEN, CERTIFIED PUBLIC ACCOUNTANT

The masses chant, "We want jobs! We want jobs! We want jobs!"

The politicians chant, "We'll create jobs for you! We'll create jobs for you."

The politician goes to Washington, D. C., with visions of grandeur. His goal is to create millions of jobs for his constituents.

The very first order of business is to hire a secretary to keep up with all of the thank you notes for creating so many jobs. Then hire a public relations man to take care of all of the newspaper reporters that will be calling to get his great secrets of wisdom on creating jobs. Millions of jobs. The economy is now on the move. He has created two new jobs; he only lacks 999,998 more and then he will be famous.

This vision of success seems to be the Great American Dream. Politicians are subjected to this dream because it will keep them in the place of honor. They will continue to be elected every two, four, or six years. . .

The first big program is to build lots of parks where people can stroll through beautiful scenery, go swimming, play tennis, relax in the shade of a beautiful tree. So a bill is passed that says lots of recreation parks will be built in every town in the United States. Big towns, medium towns, little towns will all have beautiful parks. The goal has been reached. More jobs are available. People are going back to work. They have something to do. The politician is now famous. His re-election has been assured.

Everybody is now happy. Well maybe. A new problem has raised its ugly head. Money is needed to pay the people who are planting the trees so there will be lots of shade trees in the park so people who are not working can have a place to relax in the shade of the shade trees.

(continued)

How to raise the money? Increase taxes to pay the bills for the labor to plant the shade trees. But people don't like to pay taxes! Raising taxes at this point in time is out of the question. Well maybe, well maybe not. A partial solution is raise the taxes on the rich. This is always a popular battle cry. Make the rich pay for it. Those that make one hundred thousand will have to pay sixty percent of their earnings, those making fifty thousand will have to pay fifty percent, those making twenty-five thousand will have to pay thirty percent; then those making fifteen thousand or less will have to pay twenty percent. The problem has now been solved. To hell with equality--this is fair. Raise taxes on the rich. Everybody can now sit under the shade tree and look at the beautiful scenery.

Something went wrong. A new problem has cropped up. The tax payers living standard is lower. He has less money to spend. Not as much food on the table as before. The kids are having to wear their clothes longer... The wife must go to work. Yes, taxes cause the working man to have less money, which means he has a lower living standard.

So what happens! The factory worker goes on strike so he will get a bigger salary, so he'll have more food and clothes. The employer gives him his raise. Prices go up. Taxes go up. We've moved from a twenty percent bracket to a thirty percent bracket. Need another raise, get in a higher bracket, have prices go up more; bigger salaries mean higher prices for our products. Keep the old circle going.

This great big mess was all created from a politician wanting to create jobs for his constituents. His intentions were good, but the end results were lousy.

There is only one way to create a job. It does not cost the taxpayer anything. Jobs are created by an individual going into business for himself. Yes! It is just that simple. You start your own business, as the business grows you will need employees. The more employees you hire, the bigger the business. The higher the taxes you have to pay the less money you have to hire employees and to buy equipment.

In order to create jobs the politician should try to create an economic climate that encourages people to go into business for themselves. When this happens, we will reverse the terrible cycle we are now in and cause our nation to once again become the envy of the world.

Mr. SKELTON. Thank you so much, Mr. Green. Mr. Duffel? Did I pronounce your name correctly?

Mr. DUFFEL. Yes.

TESTIMONY OF BORDEN DUFFEL, CERTIFIED PUBLIC ACCOUNTANT

Mr. DUFFEL. My name is Borden Duffel. I am a certified public accountant in public practice here in Abilene.

The following issues and proposed actions were developed by the Small Business Issues Conference held in Washington, DC, on June 8 through 11, 1984.

This conference was attended by 10 delegates from the American Institute of Certified Public Accountants, Small Business Committee, and 25 delegates each from the U.S. Chamber of Commerce, National Federation of Independent Business, National Small Business Association, and Small Business United.

I feel that we are very fortunate in having input from this small business issues conference, and these 110 delegates who spent 4 days deliberating on the problems of small business.

I have about six legal size pages here which I have submitted to the subcommittee, and I would just take a few of the items from this to present here.

The Davis Bacon Act severely reduces competition in Government construction. It eliminates the productive use of labor, the greatest advantage small contractors have, from the competitive bidding process. Small contractors cannot afford to pay the prevailing wage rate from the standard metropolitan statistical area. Currently, Davis Bacon does not allow for the inclusion of nonunion labor in the determination of the prevailing wage. Therefore, they do not bid on Davis Bacon covered contracts, eliminating small contractors from Government construction and driving up the cost of construction to Government.

On proposed action, repeal the Davis Bacon Act and those provisions in the program statutes which refer to the Davis Bacon Act in establishing prevailing wage standards. Until the Davis Bacon Act is repealed, legislation should be enacted providing for an increase in the act's contract threshold to at least $5 million.

Regarding sunset provisions in Government, too many Government regulations, programs, and instrumentalities are created or promulgated without stipulated provisions for review of their efficacy and effectiveness at a future date. This has led to a proliferation of these facets of Government, many of which are of questionable value or applicability years after they were initiated. Since no formal procedure is extant to prompt the comprehensive reviews necessary, few, if any, are eliminated once they come into being.

On proposed action, all Federal regulations, agencies, departments, and spending programs should be automatically terminated unless they are specifically reauthorized by Congress or repromulgated by the cognizant agency at least every 10 years.

About the Freedom of Information Act reform, in accordance with various Federal regulations and procedures, companies are required to convey to the Government confidential, proprietary, and competitive-sensitive information. Many businesses have been, and

continue to be, injured by the release of this information by the Government to third parties which request access to the data under the Freedom of Information Act. Under the act, the Government can do so without notifying the originator of the data, or over its objection should the originator be notified of the request.

Our proposed action is the Freedom of Information Act should be amended to contain provisions which would require notice to the originator of the information that a request for its release has been received; second, adequate time for the originator to make known any objections it has to such release with the rationale for this position; third, notice to the originator that the Government agrees or disagrees with the originator's position and its intended disposition of the data; and fourth, should the judgment be for release, the opportunity for a prompt, de novo review by an unbiased tribunal to hear the arguments for and against release and determine the ultimate disposition.

The President's Commission on Cost Containment, the Grace Commission, recently offered recommendations that could eliminate significant waste. These savings can be effected with and without legislation and could significantly reduce the Federal budget deficit.

Our proposed action is, the Small Business National Issues Conference recommends the President and Congress take immediate action to implement appropriate recommendations of the Commission.

The Presidential mandate affected departments and agencies to take appropriate administrative action to implement cost saving recommendations by December 31, 1984, and report their progress by August 31, 1985. The Office of Management and Budget monitor the implement plans of the agencies and recommend appropriate steps to accomplish the intent of the recommendations.

The Congress review the Commission report by December 31, 1984, and report appropriate implementing legislation by August 31, 1985.

Lack of long-term investment capital remains a concern for small business owners who are unable to attract financing to expand. Tax incentives are directed so that capital leaves small business investments for big business investments. An incentive to arrest the flight of capital from small business and which would also attract new capital to small business is the capital gains rollover proposal. The rollover proposal would allow an individual a deferral on capital gains taxes from the sale of any capital asset if the proceeds from the sale of the asset were to be reinvested in the common stock of a small business.

[Mr. Duffel's prepared statement follows:]

PREPARED STATEMENT OF BORDEN DUFFEL, CERTIFIED PUBLIC ACCOUNTANT

The following issues and proposed actions were developed by the Small Business Issues Conference held in Washington, D.C. on June 8 through 11, 1984. This conference was attended by ten delegates from the American Institute of Certified Public Accountants Small Business Committee and twenty/five delegates each from the U.S. Chamber of Commerce, National Federation of Independent Business, National Small Business Association, and Small Business United.

BANKING DEREGULATIONS (COMPETITION/REGULATED INDUSTRIES)

Issue

The small business community favors competition and deregulation, including a balanced and orderly deregulation of the financial sector. Unfortunately, a haphazard deregulation of the banking and financial services industries has been proceeding by use of legal loopholes and regulatory action. This haphazard development could injure small business and has the potential of seriously interrupting the flow of debt financing available to small business.

Proposed action

Small business favors deregulation of the financial service industry. This should be done in an orderly and equitable manner, and we urge Congress to deal with it quickly.

Until the development of a fair and comprehensive program, Congress should act immediately to stabilize an increasingly chaotic situation and close the non-bank loophole, while preventing banks from entering commercial activities such as real estate and insurance.

DAVIS-BACON ACT (COMPETITION/REGULATED INDUSTRIES)

Issue

The Davis-Bacon Act severely reduces competition in government construction. It eliminates the productive use of labor, the greatest advantage small contractors have, from the competitive bidding process. Small contractors cannot afford to pay the prevailing wage rate from the closest SMSA (Standard Metropolitan Statistical Area). Currently, Davis-Bacon does not allow for the inclusion of non-union labor in the determination of the prevailing wage. Therefore, they do not bid on Davis-Bacon covered contracts, eliminating smaller contractors from government construction and driving up the cost of construction to government.

Proposed action

Repeal the Davis-Bacon Act and those provisions in program statutes which refer to the Davis-Bacon Act in establishing prevailing wage standards. Until the Davis-Bacon Act is repealed, legislation should be enacted providing for an increase in the Act's contract threshold to at least $5,000,000.

SUNSET PROVISIONS IN GOVERNMENT (GOVERNMENT OPERATIONS)

Issue

Too many government regulations, programs and instrumentalities are created or promulgated without any stipulated provisions for review of their efficacy/effectiveness at a future date ("sunset provisions"). This has led to a proliferation of these facets of government, many of which are of questionable value or applicability years after they were initiated. Since no formal procedure is extant to prompt the comprehensive reviews necessary, few if any are eliminated once they come into being.

Proposed action

All Federal regulations, agencies, departments, and spending programs should be automatically terminated, unless they are specifically reauthorized by Congress or repromulgated by the cognizant agency at least every ten (10) years.

CONGRESSIONAL OVERSIGHT OF FEDERAL REGULATION (GOVERNMENT OPERATIONS)

Issue

In enacting regulatory laws, Congress has unfortunately provided regulatory agencies with overly broad delegations of authority to regulate the business community without adequate guidance as to Congressional intent and statutory authority.

Proposed action

Congress should enact regulatory laws which clearly provide statutory guidance and authority for regulatory agencies and which require Congress, on a timely basis, to approve proposed major regulations before they take effect, and which give Congress the opportunity to disapprove all other proposed regulations before they take effect.

PRODUCT LIABILITY (COMPETITION/REGULATED INDUSTRIES)

Issue

Due to inconsistent and conflicting state laws and court decisions, businesses at all levels of the manufacturing, distribution and service chain are incurring high legal costs and unpredictable liability awards. The awards often penalize parties that were not actually responsible for any injuries incurred.

Proposed action

Enact a national law in the area of product liability that would:

1. define manufacturers', distributors', and other parties' obligations in product liability for products they sell or service; and
2. make only the party responsible for any injury caused by a product or service liable for that injury.

PROCUREMENT (GOVERNMENT OPERATIONS)

Issue

Current government procurement practices result in the waste of billions of dollars annually and the denial of the opportunity for millions of small businesses to participate in Federal procurements. Numerous studies have consistently confirmed that increasing the share of procurements from small business will result in substantial savings to the Federal government. Legislation should be enacted and policies developed and implemented to ensure that the maximum amount of goods and services are procured competitively from the private sector in a manner that creates the maximum opportunity for the direct participation of small business in government procurement.

Proposed action

Specifically, the small business community recommends the following:

1. The passage of current Senate and House amendments to the 1985 Defense Authorization Act and legislation from the Senate and House Small Business Committees addressing competition in spare parts procurement.
2. The initiation of administrative action to increase the use of incentives for prime contractors and Federal procurement officers to contract with small business.
3. The continued support for the Small Business Innovation and Research Program.

FREEDOM OF INFORMATION ACT REFORM (GOVERNMENT OPERATIONS)

Issue

In accordance with various Federal Regulations and procedures, companies are required to convey to the Government confidential, proprietary, and competitive-sensitive information. Small businesses have been, and continue to be, injured by the release of this information by the Government to third parties which request access to the data under the Freedom of Information Act. Under the Act, the Government can do so without notifying the originator of the data, or over its objection should the originator be notified of the request.

Proposed action

The Freedom of Information Act should be amended to contain provisions which would require:

1. Notice to the originator of the information that a request for its release has been received.
2. Adequate time for the originator to make known any objections it has to such release (with the rationale for this position).
3. Notice to the originator that the Government agrees or disagrees with the originator's position and its intended disposition of the data.
4. Should the judgment be for release, the opportunity for a prompt de novo review by an unbiased tribunal to hear the arguments for and against release and determine the ultimate disposition.

GRACE COMMISSION (GOVERNMENT OPERATIONS)

Issue

The President's Commission on Cost Containment (the Grace Commission) recently offered recommendations that could eliminate significant waste. These savings

can be effected with and without legislation and could significantly reduce the Federal budget deficit.

Proposed action

The Small Business National Issues Conference recommends the President and Congress take immediate action to implement appropriate recommendations of the Commission:

1. The President mandate affected departments and agencies to take appropriate administrative action to implement cost saving recommendations by December 31, 1984, and report their progress by August 31, 1985.
2. The Office of Management and Budget monitor the implementation plans of the agencies and recommend appropriate steps to accomplish the intent of the recommendations.
3. The Congress review the Commission report by December 31, 1984, and report appropriate implementing legislation by August 31, 1985.

SMALL BUSINESS PARTICIPATING DEBENTURES (CAPITAL FORMATION)

Issue

Current tax laws discourage investors from directing funds to small business in the form of either loans or equity.

Proposed action

Pass enabling legislation permitting the issuance of Small Business Participating Debentures, providing for a fixed rate of interest plus a participation redeemable at a predetermined price on a future date and involving no ownership interest. The participating share of earnings would be taxed to the investor as a long-term capital gain, but deductible by the issuing campany. Losses would be deductible in the amount of $100,000. It would combine the benefits of equity and debt financing which would make private investment in small businesses desirable.

FRINGE BENEFIT EQUITY (HUMAN RESOURCES)

Issue

Small business owners are discriminated against by federal tax laws which provide tax deductible statutory fringe benefits to incorporated businesses, but do not allow similar tax deductible fringe benefits to the owners of unincorporated businesses. In cases where tax deductible fringe benefits are allowed to all types of businesses, unfair restrictions are placed on small businesses.

Proposed action

1. Legislation should be enacted providing fringe benefit equity in small business. As an example, partners and proprietors should be included as "employees" as being eligible for participation in Accident Health Plans, group Term Life Insurance, Employee Death Benefit, etc., for the purpose of having these benefits provided as a normal business expense.
2. Internal Revenue Code provisions relating to top-heavy pension plans should be reviewed for their effect and impact on small business.

TAX DEFERRAL ON REINVESTMENT OF CAPITAL GAINS IN QUALIFYING SMALL BUSINESS (CAPITAL FORMATION)

Issue

Lack of long-term investment capital remains a concern for small business owners who are unable to attract financing to expand. Tax incentives are directed so that capital leaves small business investments for big business investments. An incentive to arrest the flight of capital from small business and which would also attract new capital to small business is the capital gains rollover proposal. The rollover proposal would allow an individual a deferral on capital gains taxes from the sale of any capital asset if the proceeds from the sale of the asset were to be reinvested in the common stock of a small business.

Proposed action

Legislation should be enacted to allow for a deferral of capital gains taxes on the sale of any capital asset or investment if the proceeds are reinvested in the common stock of a small business.

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REDUCING REGULATORY ABUSE AND PAPERWORK BURDEN (GOVERNMENT OPERATIONS)

Issue

Far too often, small business owners are required to deal with unreasonable regulation, duplicative paperwork, and egregious enforcement that cannot be justified. And to make this problem worse, the most serious regulatory, paperwork, and enforcement problems are found in the Internal Revenue Service and the Defense procurement system which have successfully exempted themselves from the scope of these laws. Agencies and the courts have tried to continually reduce the scope and strength of each of these Acts which were designed to reduce administrative costs and burdens on small business.

Proposed action

A. The Equal Access to Justice, Regulatory Flexibility and Paperwork Reduction Acts should be strongly enforced and extended to specifically include the Internal Revenue Service and the Defense Procurement system.

B. The Equal Access to Justice Act and Paperwork Reduction Act should be made permanent law.

C. The Equal Access to Justice Act "substantially justified" test should be applied to all of an agency's activities and not just the agency's position in court.

D. In keeping with the thrust of these public laws, the Federal government must:

1. recognize and internalize the unique characteristics, limitations, and requirements of small business;

2. improve the size and quality of education programs, particularly in the more technical regulatory areas;

3. develop a more co-operative and less adversarial approach to regulatory development and enforcement.

JOBS CREATION CREDIT (TAXATION)

Issue

The majority of small businesses are labor intensive and do not benefit proportionally from the investment tax credit. They need capital for growth, but do not have the same access to the capital markets as do big businesses. A jobs creation credit, based on employee growth, would direct capital to growing small businesses and provide additional working capital, thus providing new opportunities for employment and vocational jobs retraining.

Proposed action

It is proposed that a jobs creation credit based on employee growth be instituted to assist labor intensive small businesses. The tax credit should be applied against income tax liability.

FEDERAL DEFICIT (ECONOMIC POLICY/INTERNATIONAL TRADE)

Issue

Spending by the Federal government of the United States is out of control. The Federal deficits resulting from this spending jeopardize our families and future generations and could lead to the economic and social collapse of our country and its institutions. Deficits contribute to high inflation, higher interest rates, higher unemployment, and a lower standard of living for all Americans. Previous attempts at balancing the budget or reducing spending have failed. Our elected representatives have not demonstrated an ability to place the economic survival of our country before political re-election goals.

Proposed action

The "down payment" proposals now before Congress are woefully inadequate. We must have dramatic action this year, not promises for the next year.

A. Short Term (Immediate action).

1. An immediate one-year freeze of the total Fiscal Year 1985 spending at Fiscal Year 1984 levels.

2. Permanently adjust Cost of Living Adjustment increases to less than the Consumer Price Index increase.

B. Long Term (five-year).

1. Balanced Budget Amendment. Small business supports the concept of a constitutional amendment to force a balanced federal budget (to include all federal spend-

ing) provided that the requirement can be overridden by a two-thirds majority of both the House and the Senate.

2. Limiting Federal Spending. Small business supports the effort to balance the budget and reduce the federal deficit by limiting total Federal spending to a percentage of Gross National Product.

3. Line-item Veto Amendment. Small business supports a constitutional amendment giving the President of the United States appropriation bill line-item veto power. The veto could be overridden by a simple majority of the House and the Senate.

4. Waste Reduction. Small business supports intensive effort to eliminate government inefficiency and waste, including implementing those Grace Commission recommendations which are appropriate, and eliminating direct or indirect government competition with small business.

C. Taxation.

1. Tax increases must not be used by Congress as a bailout for failure to implement the short and long term recommendations above.

2. Tax indexation must not be eliminated or delayed.

Mr. SKELTON. Thank you so much, Mr. Duffel. As you see, because of our numerous witnesses, we will have to hold you to 5 minutes.

Gentlemen, without objection, I'm going to suggest that everyone's testimony in full, without further comment, be incorporated into the record, and unless you object at the particular time, so that they may be allowed to summarize. That might assist us to proceed in a more expeditious manner. So, without objection, that is ordered.

Mr. Sutton?

Mr. SUTTON. Yes, Mr. Chairman.

TESTIMONY OF WILLIAM SUTTON, PRESIDENT, INDUSTRIAL MANUFACTURING CO.

Mr. SUTTON. I'm William Sutton, president of Industrial Manufacturing Co. in Sweetwater, TX. We are fabricators of liquefied petroleum gas system tanks, LPH motor fuel tanks, LPH service station dispensers as well as fabricators of ASME Code Air receivers, water tanks and anhydrous ammonia and special pressure vehicles, to give you a background of the company.

We have been in business 36 years, having built everything from golf carts to municipal water tanks and a whole catalog of items from the very largest to the smallest.

I would address this hearing regarding a problem we as small businessmen are facing in trying to gain Government contracts.

I'd like to illustrate just one little thing, and Congressman Stenholm is aware of this: The Commerce Business Daily, dated February 23, 1984, listed a request for bids for "pressure tank," MC-11, 22 each, solicitation No. 4-59820. A proper request for the bid package was initiated. Upon receipt of the package on March 8, 1984, I found it contained no specifications or drawings.

A call to the contract officer who then informed me that the Government had no drawings, no specifications. Only a company known as the Davey Compressor Co., and they, Davey, would not release this information.

The contract officer, Mr. Derwin Laster, who discussed this with his superiors, the possibility of delaying the bid date in order that we could purchase the engineering drawings and specifications so

that IMCO, our company, and other small businesses could submit a bid on these tanks.

His superiors would not delay the bid, nor purchase the necessary blueprint from the Davey Compressor Co. I know the MC-11 compressor that is the subject of this bid has been used by Government agencies for many years. The Davey Compressor Co. has never released the data to agencies who purchase the item.

Now, this withholding of data does not allow competitive bidding. Only Davey Compressor and Eagle Air Systems, which I understand is the same conglomerate, have ever bid on these items.

Now, if I understand Public Law 98-72 correctly, I'll try and paraphrase, "A clear description of the property, supplies, or services to be contracted for, which description is not unnecessarily restrictive of competition."

Gentlemen, this is just one example of the problems. My company needs contracts like this to stay in business and provide jobs to Nolan County residents.

I hope you understand my frustration. Thank you for your consideration.

[Mr. Sutton's prepared statement follows:]

PREPARED STATEMENT OF WILLIAM SUTTON, PRESIDENT, INDUSTRIAL MANUFACTURING CO.

William (Bill) Sutton, President of Industrial Manufacturing Company of Texas—Sweetwater. IMCO fabricates: Liquid Petroleum Gas system tanks; LPG Motor Fuel tanks; LPG service station dispensors; LPG hot oil fuel tanks. Designers and fabricators of ASME Code Air receivers, water tanks, NH_3 (Anhydrous Ammonia) and special pressure vessels.

IMCO has been in business 36 years. Having built everything from Golf Carts to municipal water tanks and a whole catalog of items from the very largest to the smallest. More than 60,000 quality tanks have been produced in the past 36 years.

I would address this hearing regarding a problem we as small businessmen are facing. May I illustrate:

Commerce Business Daily, dated 23 February 1984 listed a request for bids for "Pressure Tank", MC-11, 22 each Solicitation Number 4-59820. A proper request for the bid package was initiated. Upon receipt of the package 8 March 1984, I found it contained no specifications or drawings. A call to the contract officer who then informed me that the Government had no drawings, no specifications. Only the Davey Compressor Company and they (Davey) would not release this information.

The contract officer, Mr. Derwin Laster, discussed with his superiors the possibility of delaying the bid date in order to purchase, or engineer drawings and specifications so that IMCO and other small business firms could submit a bid on these tanks. His superiors would not delay the bid, nor purchase the necessary blue print from the Davey Compressor Company.

The MC-11 compressor that is the subject of this bid has been used by government agencies for many years. The Davey Compressor Company has never released the data to agencies who purchase this item. This withholding of data does not allow competitive bidding.

Only Davey Compressor and Eagle Air Systems, (which I understand are in the same conglomerate) have ever bid on these items.

If I understand PL 98-72 (3) ..... "(A) a clear description of the property, supplies, or services to be contracted for which description is not unnecessarily restrictive of competition."

This, sirs, is just one example of problems small business are confronted with when trying to win Government Contracts. My company needs these contracts to stay in business and provide jobs to Nolan County residents.

I hope you understand my frustration.

Thank you for your consideration.

Mr. SKELTON. Thank you, Mr. Sutton. Mr. Jones?

TESTIMONY OF RAYMOND L. JONES, TEXAS AUTO PARTS

Mr. JONES. Mr. Chairman, gentlemen of the committee, my name is Raymond Jones. I operate three businesses here in Abilene: Texas Auto Parts, National Automatic Transmissions, and National Engines.

With reference to the House Small Business Committee hearing, I would like to make this statement. We have operated three businesses in Abilene for the past 35 years. We have made our family a good living and provided many jobs for employees over these years. We feel we have made an outstanding contribution to the community, both financially and with many hours of community service. We have now reached the time when we must close one of these businesses not because of lack of business, but because we are unable to find people who are willing to work.

These workers are the product of our educational system, that our tax dollars have paid for. A large number of these workers are unable to read well enough to follow simple instructions, yet we are giving school teachers a raise in pay and other increased benefits. A great number of employees have no pride in their work, and will not report for work half the time. Money is not important to them.

Enclosed find a copy of added on extra unemployment tax charges I must pay to help all these unemployed. If you can make reason out of closing an operating business of 35 years because of lack of workers, yet so many are out of work that I must pay an added on unemployment tax.

We have hired 24 people in 1984, to date we have 5 people working. All the rest have quit. We need at least 10 employees to operate; we have not had 10 people working at one time in the past 2 years. Enclosed find a work record of a productive employee. His daughters moved back home with children and both girls have been deserted by the children's fathers.

Our employee filled out Government assistance forms on February 3, 1984. My wife, who is my bookkeeper, was told by a Government agency that she had to complete form 1028 in order for our employee to get Government assistance.

No effort was made to encourage the fathers of these children to support them. Instead, the grandfather, our employee, was placed on these assistance programs.

Enclosed find a copy of our employee work record for 1983 and 1984. Please note employee soon missed work and shortly afterward quit. He now receives food stamps, medical assistance and an adjusted income supplement and is not working. He is doing some automotive repair at his home, for cash only. This productive man went out of the work force at 45 years old. This is not an isolated case. It happens over and over again.

Every businessman I talk with has the same problem. That concludes my written statement, and I will hasten to add that I have some very loyal employees. I've had one employee that's worked for me for 30 years, I've had one that worked for me for 25 years, subsequently died, and I have not been able to replace him. I have others who have worked for me for 10 years. But, full-time employees are very difficult to hire, and I think it's not just my problem,

it's a universal problem with all small businessmen. It is my opinion that the welfare system is going to sink America if we don't do something about it.

I urge you to do what you can to correct the misuse of it. I know that it was a good thought when it was instituted, but the abuse of it is pitiful.

I cannot remember a single person that has been severely reprimanded or jailed or paid a fine in Abilene, TX, for welfare abuse. There may be some that I'm not aware of. But, if there is, I never see it in the papers.

Once in a great while, we will see welfare cases brought up, but you never see any results.

I think it's something that needs to be brought to your attention.

Thank you for letting me testify.

[Mr. Jones' prepared statement with attachments follows:]

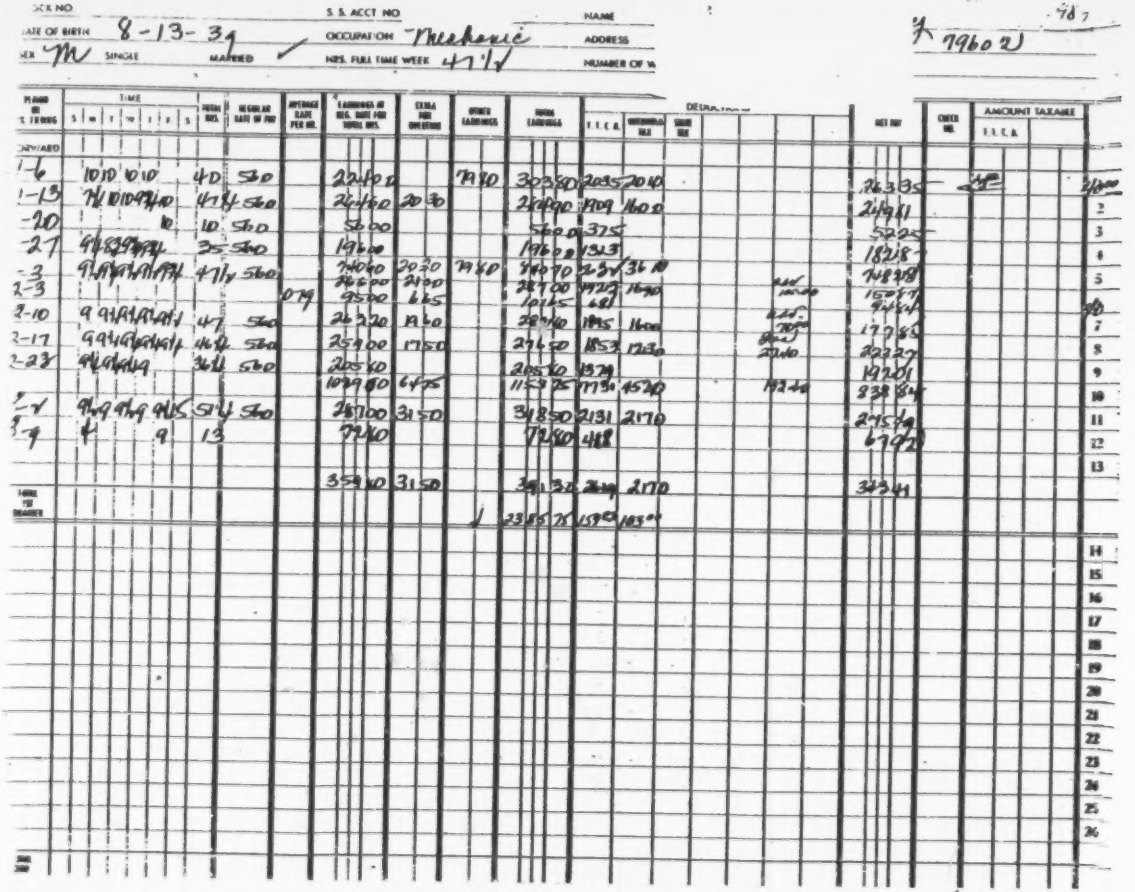
Prepared Statement of Raymond L. Jones, Texas Auto Parts

With reference to the article in the Abilene Reporter News concerning the House Small Business Committee hearing on July 11th, here in Abilene, I wish to submit the following information and would like to read my statement to the committee.

We have operated three business in the Abilene vicinity for the past 35 years and we have made our family a good living and have provided many jobs for employees over these years. We feel we have made an outstanding contribution to this community both financially and with many hours of community service. We have now reached a time when we must close one of these business, not because of lack of business, but because we are unable to find people who are willing to work. These workers are products of our educational system that our tax dollars have paid for. A large number of these workers are unable to read well enough to follow simple instructions; yet we are giving our school teachers a raise in pay and other increased benefits. A great number of employees have no pride in their work and will not report for work half the time, money is not important to them. Enclosed find a copy of an added on extra unemployment tax charge I must pay to help all these unemployed. If you can make reason out of closing an operating business of 35 years because of lack of workers, yet so many are out of work that I must pay an added on unemployment tax?

We have hired 24 employees in 1984, to date we have five people working, all the rest have quit, we need at least ten employees to operate; we have not had ten people working at one time in the past two years.

Enclosed find a work record of a productive employee. His daughters moved back home with children and both girls had been deserted by the childrens fathers. Our employee filed for government assistance on the 2-3-1984. My wife, who is my bookkeeper, was told by a government agency that she had to complete form 1028 in order for our employee to get governmnet assistance; no effort was made to encourage the fathers of these children to support them, instead the grandfather, our employee was placed on these assistance programs. Enclosed find a copy of our employee work record for 1983 and 1984. Please note employee soon missed work and shortly afterward quit. He now receives food stamps, medical assistance and an adjusted income supplement and is not working. He is doing some automobile repair at his home, <u>for cash only</u>. This productive man went out of the work force at 45 years old. This is not an isolated case, it happens over and over. Every businessman I talk with has the same problem.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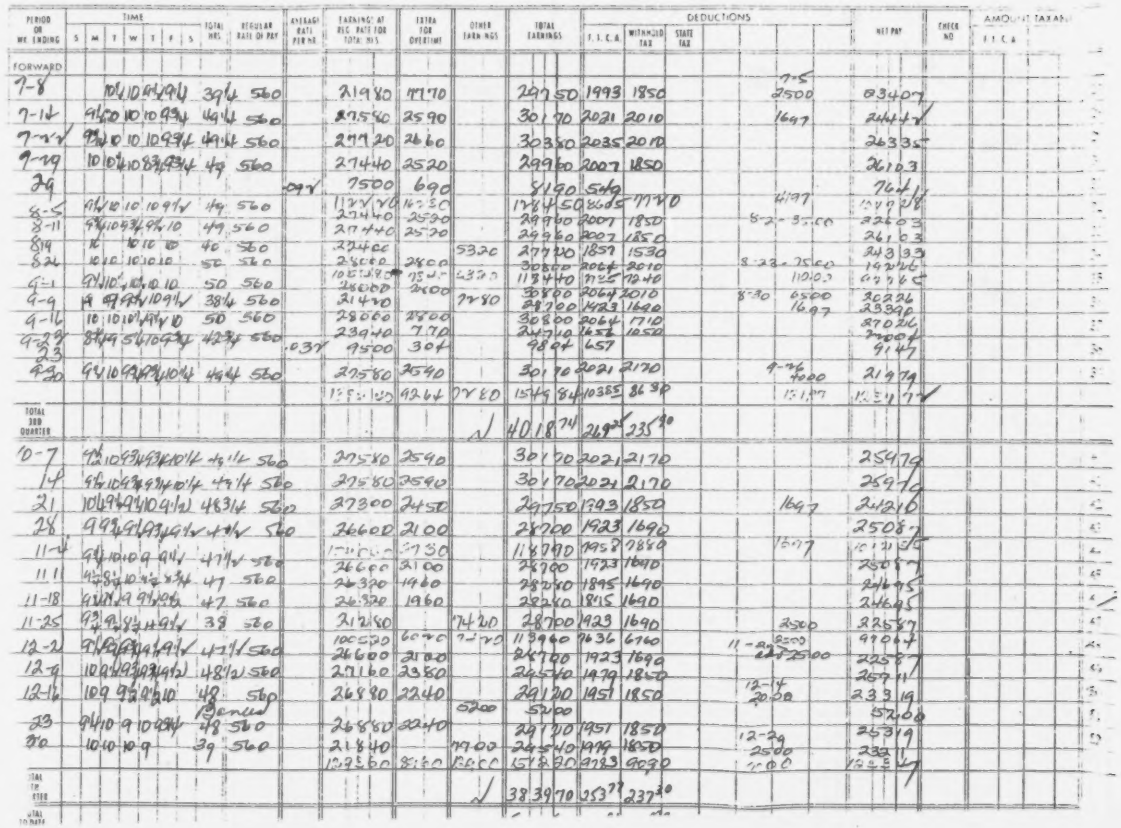

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11 11	9¾ 10 9¾	47	560		26600	2100		28700	1923	1690			25087		
11-18	9½ 9 9½	47	560		26320	1960		28280	1895	1690			24695		
11-25	9¾ 9¼ 9¾ 9¼	38	560		21280		7420	28700	1923	1690		2500	22587		
12-2	9½ 9¾ 9¾ 9¼	47¼	560		26600	2100		28700	1923	1690		11-29 2500	22587		
12-9	10 9¾ 9¾ 9½	48½	560		27160	2380		29540	1979	1850		12-14 2000	23711		
12-16	10 9 9½ 10	48	560		26880	2240		29120	1951	1850			23319		
	Bonus						5200	5200					5200		
23	9¼ 10 9 10 9¾	48	560		26880	2240		29120	1951	1850		12-29 2500	25319		
30	10 10 10 9	39	560		21840		7700	29540	1979	1850			23961		
					1295 60	8260	13120	154680	10373	8630		5000	13353		
TOTAL FOR YEAR								383970	25377	23770					
TOTAL TO DATE															

22

EMPLOYMENT VERIFICATION

Form I
Pa

1. Is person named employed by you? ..... ☑ Yes ☐ No

DATE HIRED	DATE TERMINATED	IF TERMINATED, REASON
April 1982		

2. Employee is: ☐ Full Time (30 hrs. or more) ☐ Part Time (less than 30 hrs.)

3. How often paid? ☐ Daily ☑ Weekly ☐ Every two weeks ☐ Twice monthly ☐ Monthly

4. Is employee paid commission? ☑ Yes ☐ No Or tips? ..... ☐ Yes ☐ No

5. Is he/she usually paid overtime? ☑ Yes ☐ No

6. Will there be any changes in his/her pay during the next few months? No

If "yes," explain:

7. Address of employee: [illegible] 79602

ON THE CHART BELOW, PLEASE PROVIDE INFORMATION FOR [illegible] PAY PERIODS.
If this is a new employee, show the employee's hourly rate (salary), average hours per pay period, and date of first pay check in the comments section below

DATE PAID	HOURS	GROSS PAY	INCOME TAX	FICA	OTHER DEDUCTIONS (describe)
1-6-84	40	303.80	20.10	20.35	
1-13-84	47 1/4	284.90	16.00	19.09	
1-20-84	10	56.00		3.75	
1-27-84	35	196.00		13.13	

Comments: (add any information which you think is important):

COMPANY OR NAME OF EMPLOYER	ADDRESS—STREET OR P.O. BOX, CITY, STATE, ZIP		
Leedon Credit Party	P.O. Box 1673 Abilene Texas 79604		
SIGNATURE—PERSON PROVIDING THIS INFORMATION	TITLE	DATE	TELEPHONE NO.
[signature]	Blazer	2-3-1984	6774368

TEXAS EMPLOYMENT COMMISSION
Austin, Texas
June 4, 1984

NOTICE OF ADDITIONAL TAX

RAYMOND L JONES
TEXAS WRECKING CO
BOX 1673
ABILENE TX 79604

211182

00-118585-3

Dear Employer,

House Bill 896 enacted by the regular session of the 68th Texas Legislature provided, in addition to other taxes, an Interest Tax to pay the interest on Federal advances.

The rate of this tax is 25 percent for 1984 applied to the amount of taxes paid or due for the portion of 1983 for which you were entitled to an experience rating.

This tax is due at the same time as your unemployment tax payment for the second quarter. It may be paid without penalty on or before July 31, 1984.

Computation of Amount Due

Previous Balance Due	$	.00	
+ ADDITIONAL TAX	$	97.06	(25% of 1983 Tax)
Total Due	$	97.06	
- Credit Balance	$	.00	
NET AMOUNT DUE	$	97.06	

If the computation above shows net amount due,
PLEASE RETURN THIS STATEMENT WITH YOUR PAYMENT BY JULY 31, 1984.
Mail to: Texas Employment Commission
P. O. Box 2908
Austin, Tx 78769

Mr. SKELTON. Mr. Jones, we thank you, sir. Mr. Shelby, before I call you, I'm going to have to say again for the kinfolk in Missouri, that's a very famous, not widely distributed name: Shelby. There are many who live right near my home area.

Mr. SHELBY. Probably is.

Mr. SKELTON. The family of a very famous Confederate general, who, by the way, right after the war, came down through Texas on the way down to fight with Maximillian.

Mr. SHELBY. General Joe.

Mr. SKELTON. General Joe, and his family still exists in our neck of the woods. With that, I will call on Mr. Shelby.

TESTIMONY OF LEX SHELBY, CONSULTANT PHARMACIST, SHELBY PHARMACY

Mr. SHELBY. Mr. Chairman, and members of the committee, thank you for the opportunity to testify before you today. I am Lex Shelby, a resident of De Leon. I would like to briefly address two issues, particularly of concern to the pharmacists of Texas small businessmen.

The first issue is price discrimination, or, as it is known, predatory pricing. This practice is one of the most dangerous forces the pharmacy profession faces today. Under this practice, drug manufacturers charge different prices for the products, they sell differently, and to be more precise, they often charge lower prices to chain drugstores than they do to local independent pharmacies. They charge even lower prices to hospitals than they do to chain pharmacies.

I am talking of known instances, such as nitropatches, for an example, are being sold to community pharmacies for $28 to $30 a box, and are being sold to hospitals for $1 a box. This means that there are 30 patches in this box being sold to the pharmacy for $1 a patch, and are being sold to the hospital for 3 cents a patch. What sometimes happens is that the hospitals then sell their products directly to outpatients or even to community pharmacists and fair competition is wiped out.

Pharmacists oppose this situation, but in seeking a remedy, they do not necessarily need a new law. The law is already on the books. The Robinson-Patman Act prohibits discriminatory pricing, and two U.S. Senate cases, particularly relating to pharmaceutical services, have been upheld by this law.

In 1976, the case of *Abbott Laboratories* v. *Portland Retail Drug Association* specifically states that the Robinson-Patman Act applies to the sale of pharmaceutical products to nonprofit hospitals, if these products are to be resold.

In the 1983 case of *Jefferson County Pharmaceutical Association* v. *Abbott Laboratories,* the Supreme Court ruled that the act also applies for the resale to pharmacies owned by State and local governments. As pharmacists, we request several actions. We ask Congress to investigate the unfair pricing practices that prevail among many companies within the pharmaceutical industry.

This investigation should be particularly looked into, the practice of predatory pricing as it relates to the *Portland* and the *Jefferson* cases that I have just mentioned.

Second, we ask that Congress encourage the Federal Trade Commission and the Justice Department to enforce the Robinson-Patman Act, and that the agencies earmark funds for this purpose.

Finally, I encourage congressional support for H.R. 5237 by Congressman Ed Markey. This bill adds further language making it unlawful to sell goods below cost in an effort to injure, destroy, and prevent competition. This bill, which would authorize triple damages for anyone injured by such predatory pricing——

Mr. SKELTON. May I interrupt you, sir? Is that limited to pharmaceuticals or is that a broad bill?

Mr. SHELBY. I am not sure. I am not sure.

Mr. SKELTON. I was wondering if it was limited.

Mr. SHELBY. It certainly affects pharmacies, but I don't know.

This bill, which would authorize triple damages for anyone injured by such predatory pricing is in the House Judiciary Committee on Monopolies and Commercial Law.

The second issue I would like to address is equally important to pharmacists. It has to do with the pharmacists, to bargain collectively on third party programs.

Some people do not know what is meant by a third party program, but in the case of a pharmacy, it is simply this, a customer brings in his or her prescription, the pharmacist fills the prescription, and a third party, the insuror or his administrator, pays it.

Unfortunately, the fees paid by these third party programs are set arbitrarily low. In the 25 years that third party programs have been in existence, these arbitrarily established fees have failed to keep pace with the inflationary cost of doing business. There has been no acknowledgment by the third party industry of the rising costs of drugs. Thus, pharmacists have seen a steady decline in recent years for their return on investment.

But, what happens when the pharmacist seeks relief? Very simply, we are told to "take it or leave it," because the third party industry has a strong ally. Federal antitrust law says that pharmacists cannot bargain collectively on fees.

So, what are the pharmacist's alternatives? He or she can swallow the bitter pill of low prices, low fees, and wonder how long their pharmacy can stay open with profits dwindling to nothing, the pharmacist can tell the customer he no longer accepts payments from the third party program, and kiss goodbye the business of that customer and probably the rest of the family business. Or, the pharmacist can accept the low fees and shift the cost to the unfortunate customer who does not belong to a third party program.

Pharmacists are not seeking anything unfair in this issue. We are only asking our basic rights. Pharmacists want to remain open, want to provide health services to our customers. To do that, we must be allowed to make a profit, and to make a profit, we must be able to negotiate our fees.

There are two bills in Congress specifically addressing this issue. H.R. 752 by Congressman Joseph Addabbo and Congressman Hamilton Fish in the House Judiciary Committee Subcommittee on Monopolies and Commercial Law, and S. 2051 by Senator Arlen Specter is in the Senate Judiciary Committee.

Both bills would exempt pharmacists from antitrust laws and permit collective negotiations for fair fees.

[Mr. Shelby's prepared statement with attachment follows:]

PREPARED STATEMENT OF LEX SHELBY, CONSULTANT PHARMACIST, SHELBY PHARMACY

Mr. Chairman, members: Thank you for the opportunity to testify before you today. I am Lex Shelby, a resident of De Leon. I would like to briefly address two issues of particular concern to Texas pharmacists as small businessmen.

The first issue is price discrimination or, as it also is known, predatory pricing. This practice is one of the most damaging forces the pharmacy profession today faces. Under this practice, drug manufacturers charge different prices for the products they sell, depending on who they sell to. To be more precise, they often charge lower prices to chain drugs stores than they do to local independent pharmacies, and they charge even lower prices to hospitals than they do to chain pharmacies.

I am not referring to examples of volume discount. I am talking of known instances in which nitro-patches, for an example, are being sold to community pharmacies for $28 to $30 a box and are being sold to hospitals for $1 a box. And what sometimes happens is that the hospitals then sell their products directly to outpatients or even to community pharmacies, and fair competition is wiped out.

Pharmacists oppose this situation, but in seeking a remedy they do not necessarily need a new law. The law is already on the books. The Robinson-Patman Act prohibits discriminatory pricing. And two U. S. Supreme Court cases particularly relating to pharmaceutical services have upheld this law. The 1976 case of Abbott Laboratories v. Portland Retail Druggists Association specifically states that the Robinson-Patman Act applies to the sale of pharmaceutical products to nonprofit hospitals, if these products are then resold. In the 1983 case of Jefferson County Pharmaceutical Association v. Abbott Laboratories, the Supreme Court ruled that the Act also applies to sales, for resale, to pharmacies owned by state and local governments.

As pharmacists we request several actions: We ask Congress to investigate the unfair pricing practices that prevail among many companies within the pharmaceutical industry. This investigation should in particular look into the practice of predatory pricing as it relates to the Portland and Jefferson County cases I just mentioned.

Second, we ask that Congress enccurage the Federal Trade Commission and the Justice Department to enforce the Robinson-Patman Act, and that the agencies earmark funds for that purpose.

Finally, we encourage Congressional support for H.R. 5237 by Congressman Ed Markey. This bill adds further language making it un-

lawful to sell goods below cost in an effort to injure, destroy or prevent competition. This bill, which would authorize triple damages for anyone injured by such predatory pricing, is in the House Judiciary Subcommittee on Monopolies and Commercial Law.

The second issue I would like to address is equally important to pharmacists. It has to do with allowing pharmacists to bargain collectively with third party programs.

Some people do not know what is meant by a third-party program, but in the case of a pharmacy it is very simply this: a customer brings in his or her prescription, the pharmacist fills the prescription, and a third party--and insuror or his administrator--pays it.

Unfortunately, the fees paid by these third party programs are set arbitrarily low. In the 25 years that third party programs have been in existence, these arbitrarily established fees have failed to keep pace with the inflationary cost of doing business. There has been no acknowledgement by the third party industry of the rising costs of drugs. Thus pharmacists have seen a steady decline in recent years in their return on investment.

But what happens when pharmacists seek relief? Very simply we are told to "take it or leave it," because the third party industry has a strong ally. Federal antitrust law says that pharmacists cannot bargain collectively on fees.

So what are the pharmacist's alternatives. He or she can "swallow" the bitter pill of low fees, and wonder how long their pharmacy can stay open with profits dwindling to nothing. Or the pharmacist can tell the customer he no longer accepts payments from that third party program, and kiss goodbye the business of that customer and probably the rest of the customer's family. Or the pharmacist can accept the low fee and shift the cost to the unfortunate customer who does not belong to a third party program.

Pharmacists are not seeking anything unfair in this issue. We are only seeking our basic rights. Pharmacists want to remain open, want to provide health service to our customers. To do that we must be allowed to make a profit. And to make a profit we must be able to negotiate our fees.

There are two bills in Congress specifically addressing this issue. H. R. 752 by Congressman Joseph Addabbo and Congressman Hamilton Fish is in the House Judiciary Committee Subcommittee on Monopolies and Commercial Law. S. 2051 by Senator Arlen Spector is in the Senate Judiciary Committee. Both bills would exempt pharmacists from antitrust laws and permit collective negotiation for fair fees.

In thinking of third party programs, remember that there are four parties involved. The employer decides he would profit from employee morale by offering more benefits, so he sets up a third party drug program as an employee benefit. An insuror determines he will make a profit from the program, so he funds it. An administrator decides he will make a profit by doing the data claims processing for the insuror, so he administrates the program.

All three of these parties willfully enter the program, and together they decide how much they will charge, and how much they will pay. They set up the program. They negotiate their fees. The marketplace works.

And then the pharmacist is asked to fill a prescription at a price the other parties arbitrarily set and, if he complains, the flag of antitrust law is waved in front of his face and he is told to "take it or leave it." Of all the parties involved, only the pharmacist has to accept arbitrarily set prices determined by people outside his practice or business.

Unless this problem is solved, prices will continue to go up for non-third party customers, and eventually pharmacies will close for lack of profits. And the person who will suffer is the patient. Collective bargaining for pharmacists would do much to solve this problem.

I appreciate being given the opportunity to testify and will be happy to answer any questions.

38-814 O--84----3

REGARDING TESTIMONY OF LEX SHELBY

H.R. 5237 Rep. Markey, et al.; 3/22/84. Judiciary

Fair Competition Act of 1984 - Amends the Clayton Act to prohibit any person engaged in commerce to sell, or contract to sell, goods below cost where the effect may be to injure, destroy, or prevent competition in or affecting commerce. Authorizes any person injured in business or property as a result of a violation of this Act to sue for treble damages in U.S. district court.

H.R. 752 Rep. Addabbo, et al.; 1/25/83. Judiciary

Prepaid Prescription Program Negotiation Act - Establishes an antitrust exemption to permit groups of professional pharmacists to negotiate collectively with the sponsor of a prepaid prescription program concerning their reimbursement by the third-party insurer.

S. 2051 Sen. Specter; 11/4/83. Judiciary

Health Care Cost Containment Act of 1983 - Grants an antitrust exemption to health care insurers for the purposes of: (1) acquiring data on health care costs and services; and (2) entering into service and cost agreements with health care providers.

Authorizes the Attorney General to investigate such joint activities to determine whether they conform to this Act.

Mr. SKELTON. Thank you, Mr. Shelby. Congressman Stenholm?

Mr. STENHOLM. Mr. Chairman, continuing on the last subject you were talking about, would you comment a little on the perception, I think, of the majority of people in the 17th District, people of America, that drug prices have, indeed, gone up, and that part of the problem is the fact that third party payees are paying too much, not too little? Whereas from your perspective, what you're testifying is that it's just the opposite.

Mr. SHELBY. The third party programs and the insurance companies have gone up that is correct. The fees the pharmacists are collecting have not risen. We have no choice. They are arbitrarily set by the insurance companies.

We're not allowed to even discuss it among ourselves or in a group, and if an insurance company come in with Blue Cross or what have you, we're told it's going to be this and it has not risen.

The prices of drugs have gone up, and when, like on welfare or that sort of thing, it's impossible for the State of Texas to figure a price of a product for the year on their volume and the same when the drug companies are allowed to go up indiscriminately, no controls of any kind. We have not had any fee choices with any of the insurance companies at all. We take it, the price they set, which, in many cases, the pharmacists may be involved, may not be.

Mr. STENHOLM. The first issue you raised was in price discrimination, and then you went ahead and answered a question I wrote down when you first said that.

You're not talking about volume discounts.

Mr. SHELBY. Yes, sir.

Mr. STENHOLM. Amplify just a little bit more on exactly what has happened.

Mr. SHELBY. OK. An example right here, where Ciba Co. is selling its nitro-patch to us and the pharmacies for $28 to $30 a box, 30 patches to a box, we, in turn, sell to the patient for the nitroglycerin needed for sustained action. They are, in turn, selling it to the hospitals for $1 a box.

Mr. STENHOLM. I understand that. But what is their response when you raise the question that this is occurring?

Mr. SHELBY. They pay no attention, just go right on with it. We're needing the rights of the Robinson-Patman Act to be enforced and price discriminatory, pricing on that, because it is happening in other places too, and we're—we're just asking for equal practice. I can give many examples. That's one that I have, but I can meet with you or check with you and from the pharmacy industry and the independent pharmacists, we can come up with a whole lot.

Mr. STENHOLM. That brings me then to you, Mr. Sutton. I have some questions regarding the inability of small businesses to gain access to or become competitive in Government contracts, particularly military contracts. The entire Small Business Committee has considered this over the last 2 years, and I think there is a great amount of frustration in trying to find the key to unlock the door that provides for competition; that's what I hear Mr. Shelby acknowledging. We don't need another new law, we just need a little playing field so that individuals who can provide a service, and can

manufacture something that the Government needs, and be given an opportunity to bid competitively.

In your testimony, you give a couple of suggestions.

Mr. SUTTON. Oh, yes, sir.

Mr. STENHOLM. What do you think is most needed?

Mr. SUTTON. Probably is they have enacted the new public law last year, as you know. I thought, well, this is manna from heaven. This is going to provide us a real leg up, to get in there and bid, and after it was enacted, it hasn't done anything for us. The services seem to ignore it. This one poor little clerk I talked to, his superiors chose to ignore that public law, and not provide specifications or drawings.

Mr. STENHOLM. I assure you that I know all three members who are here today, and this is one area that we're very interested in, and it can be extremely frustrating. When we talk about budget cuts and making the dollar go further, I know of no better way than providing honest competition, and that's what I've heard at least two of you say here today. We just want an opportunity to compete, but we want it to be fair competition, and we don't seem to be having that in the small business sector.

Mr. SUTTON. I gave this one illustration. This is with a small number of items, but one that very obviously we could have fulfilled, and I followed the track record of this, Congressman, I know what the Government paid for those last 22 tanks.

We build a 1,000 gallon system tank for less money than they are paying for those little pressure tanks. See, had we had time, we may have been able to reverse engineer. We would have found the compressor, measured it, reverse engineered the thing. This is what Mr. Laster was attempting to get for us, trying to do this, but they chose not to allow him to do it.

Mr. STENHOLM. Was there any patent information involved in this?

Mr. SUTTON. No.

Mr. STENHOLM. Proprietary rights?

Mr. SUTTON. No, sir, doesn't seem to be. His company has built this forever, and we just keep it in our own little shop.

Mr. STENHOLM. Sole source contract, you mean.

Mr. SUTTON. They seemed to have another company that is a part of the conglomerate that wins the bid one time, and Davey Compressor wins it another time.

Mr. STENHOLM. Mr. Duffel, I thank you for your entire testimony, which I personally requested for this hearing. We were looking for an agenda for the Small Business Committee, and the testimony you presented certainly has given us a large number of items to consider.

The groups that you mentioned have helped. I would just comment briefly on the repeal of Davis-Bacon. This is an area that I am personally very involved in, and now I have some 94 cosponsors. This is one area in which common sense is going to have to prevail in sooner or later.

A repeal of Davis Bacon, we are told by almost every agency, whether it's CBO or whether it's OMB or whoever it is, would save over $1 billion a year; that's CBO's figures. Furthermore, repeal would create 100,000 new jobs and would have as much as a $20

billion ripple effect in the economy. I have experienced tremendous frustration in trying to deal with legislation to modify the Davis-Bacon Act. I would like to ask you, do you personally look at the concept of small business participating debentures enough to offer comment?

Mr. DUFFEL. No, I have not.

Mr. STENHOLM. You have not, OK. I wish you would look at that and let me know personally.

Mr. DUFFEL. All right.

Mr. STENHOLM. I think it's a concept that's got a lot of merit to it. Thank you, Mr. Chairman. I'll defer back now. You've got some other panels I'll question later.

Mr. Skelton. All right. Congressman Vandergriff.

Mr. VANDERGRIFF. Thank you, sir. I would like to continue with a question or two for you, Mr. Duffel.

You have included in the lists of recommendations references to banking deregulation, although you didn't comment on that section in your oral testimony. I note that you are saying you can perhaps have too much of a good thing. I'm speaking of banking deregulation.

If I understand you correctly, even though you approve of the concept, you're fearful of the so-called nonbank banks. You're also concerned about banks involvement in real estate and insurance transactions.

I'm interested in pursuing this point because it's possible that we'll have some banking legislations before us when we return to Washington in the next few weeks. Are you saying you'd like to see us enact some legislation that would prevent the spread of nonbank banks, and their involvement in some of these other activities?

Mr. DUFFEL. Yes, sir. Your community banks perform a very important service for your local small business, your farmers, your ranchers, people of this sort, and it is becoming more and more difficult for them to compete with Sears-Roebuck, Merrill Lynch, and organizations of that type.

And, I think it's a matter of putting a stop to that nonbank banks before they put a bunch of small community banks, which are performing important services, out of business.

Mr. VANDERGRIFF. I see. All right. Well, that's very topical now, so, I was especially interested to be certain I had a clear understanding of your recommendation.

Were you personally involved in this meeting?

Mr. DUFFEL. No, sir, I was not.

Mr. VANDERGRIFF. You were not. Then, you wouldn't know if, in the discussion relative to product liability, there was a discussion of specific legislative proposals?

Mr. DUFFEL. No, sir, I would not.

Mr. VANDERGRIFF. I happen to be cosponsor of such a proposal as you're talking about, a national law in the area of product liability. I would like to submit to you, through Congressman Stenholm, a copy of that legislation and get your reaction to it. We always have a problem here—that is State rights—when we talk about national law, but it seems that there are so many conflicting State laws and court decisions that it might be time for a national law in this re-

spect. So, I'll be interested in your thoughts on this subject. In terms of procurement, are you personally in favor of what we call small business set-asides, the concept of restricting certain types of bids to small business alone?

Mr. DUFFEL. Not necessarily. I think we should have a fair bidding system giving small business the opportunity to bid on the same level as your larger businesses. I think that as far as procurement is concerned, that your bid should be the best bid, the bid that the Government accepts should be the best bid whether it's the large business or small business.

Mr. VANDERGRIFF. I see. All right.

Mr. STENHOLM. Tom, will you yield on that?

Mr. VANDERGRIFF. Certainly.

Mr. STENHOLM. Would the others of you care to comment on that question?

Mr. GREEN. I agree with that.

Mr. STENHOLM. Whether you agree or disagree with it?

Mr. GREEN. May I make a comment on that, please? I have been on both sides of the fence, on the Government side and on the individual proprietor's side of the deal.

The biggest hangup of all in this particular area is the closed specification. The Government employee sets behind closed doors and they draw up all of these cute little words that goes along saying we're going to wind up with a certain piece of equipment. Whatever you wind up with this, the small businessman has absolutely no shot at all for the bid because his particular product will fulfill the need, but at the same time, it won't meet the Government specifications and this drives the price of it up higher.

Mr. STENHOLM. That's the problem Mr. Sutton was testifying to. My question and that of Mr. Vandergriff to Mr. Duffel, was in regard to the set-aside program in which we have had the inclination in the Small Business Committee to set aside and make sole eligibility for contracting to small business and eliminate competition from big business in a certain amount of areas.

Mr. GREEN. No, no. Leave your specifications open, gentlemen, open up your specifications. This is the key to it, not a certain set aside for the small business because small business doesn't need it. All he needs is a fair shot at providing the equipment and/or the service that you are needing.

Mr. STENHOLM. Do you agree?

Mr. SUTTON. Yes; that's true.

Mr. STENHOLM. Do you agree, Mr. Jones?

Mr. JONES. I can't speak for the manufacturing end of it, but as far as the repair end of it, over the past years that Dyess AFB has been in Abilene, I've, at times, repaired vehicles for him. It seems that you get one commander in and he does it a certain way.

I did a lot of business for awhile. Another one comes in and he changes it all up, and I have done none in the last few years. So, really, I don't know how they change them or what it is, but we, I think, do local repairs as far as repair is concerned, to do a better, cheaper job, not cheaper in quality, and moneywise than bringing a contractor in.

At one time, when we were doing a lot of repair for Dyess AFB, they brought in a contractor from out of state who took all of the

repair work and did it under a contract. We haven't repaired any vehicles since this contractor has come in. I doubt if they are getting it done at a more reasonable price.

Mr. STENHOLM. Thank you.

Mr. VANDERGRIFF. All right. Mr. Shelby, I was interested in your testimony very much. I'm wondering if, in addition to an obvious local condition prevailing in your case, it is your impression from conversations with other pharmacists that this condition prevails throughout Texas or even the Nation? I notice you're a member of both the State and national associations.

Mr. SHELBY. Yes, it is nationwide, and the Government is not even looking into it at all. They are not even checking it out, and it's two times that we have gone to—the group from Alabama and the one from Washington, Portland, have got the Supreme Court ruling. That's all the farther it goes. They do nothing up there, just like I mentioned on this bidding situation. The law is there, but we can't get anybody to act on it, and we just want an even chance on it, and Ciba is a national company.

Another thing I might mention might start like on generic drugs. Ciba has their product, to make surapis. They are selling to us. I'll buy a bottle of 1,000 for $18 a 100. Ciba has their generic company, Geneva Generics. They are making the same product available to us for $2. Now, you figure that out. All they do is change the dye, the—when they color the tablets, from a white tablet to a salmon colored, and the difference is $16 a 100. So, it's no wonder we have trouble with budgets or high prices in the pharmacies.

Mr. VANDERGRIFF. One last question on the subject. If we were to require in the legislation what you're recommending. Can we find this out readily enough, or is it possible we cannot.

You recommend collective bargaining for the pharmacists. Who would represent pharmacists in this case?

Mr. SHELBY. Probably the pharmacists association and the individuals, the pharmacy groups in the area. We're not allowed to even discuss it. If you look on the back page of my report, they get together for the one who does set up the policy, the insurance program, and all. They take their cut, but then we take what they assign us, if we want to stay in business, either we do it or we don't.

Sometimes in most instances, the fee that we are allowed to collect from third parties is considerably less than what we are allowed to collect for welfare from our State and Federal problems in collecting that.

Mr. VANDERGRIFF. All right, sir. Thank you very much. Thank you, Mr. Chairman.

Mr. SKELTON. Thank you, Mr. Vandergriff. Mr. Sutton, I am intrigued by your testimony. Let me see if I understand.

There was a requirement from the military. Now, which phase of the military? Which department?

Mr. SUTTON. Air Force, sir.

Mr. SKELTON. For a pressure tank known as MC-11; is that right?

Mr. SUTTON. Yes, sir.

Mr. SKELTON. You made a proper request for the bid package and you received that, and you found it contained no specifications or drawings?

Mr. SUTTON. Right.

Mr. SKELTON. Is that correct?

Mr. SUTTON. That's correct.

Mr. SKELTON. So, you called the contracting officer. Where was that? In Washington?

Mr. SUTTON. No, sir. He's in Warner Robins. I have the whole package here.

Mr. SKELTON. All right. What did he tell you about there being no specifications or drawings?

Mr. SUTTON. This is what he had told me.

Mr. SKELTON. What's his name?

Mr. SUTTON. Yes, sir. Derwin Laster.

Mr. SKELTON. Is he uniformed or otherwise?

Mr. SUTTON. Otherwise.

Mr. SKELTON. A state employee?

Mr. SUTTON. Yes, sir.

Mr. SKELTON. His name again?

Mr. SUTTON. Derwin Laster.

Mr. SKELTON. OK. Please proceed. Tell me what he said?

Mr. SUTTON. He said that the specifications and drawings were not available.

Mr. SKELTON. What?

Mr. SUTTON. He said that there had been many phone calls like mine——

Mr. SKELTON. Yes?

Mr. SUTTON [continuing]. For the specifications and drawings, and he agreed to talk with his superiors, to delay the bid so that either the Government could obtain the specifications or the small contractor, like myself, backward engineer, that is, find the tank, probably buy it, measure it, engineer it backward, and this was something they felt they had to have right away because they did not allow him to do this.

He and I have talked in the past week, by the way.

Mr. SKELTON. Did he say who his superior was?

Mr. SUTTON. No, sir; he did not. I did not press him. I thought I had received a lot of cooperation from him. In fact, I asked him, before I wrote the letter to Congressman Stenholm in the first place, if I wanted him to be aware that I was going to write the letter and could I use his name.

Mr. SKELTON. Well, I'm intrigued on this. A little footnote on this, I would also note that I'm on the Armed Services Committee, and this is a double concern for me. All right.

Now, where is this Davey Compressor Co. from?

Mr. SUTTON. They are in Cleveland, OH.

Mr. SKELTON. They had the specifications?

Mr. SUTTON. Yes.

Mr. SKELTON. Where did they get the specifications?

Mr. SUTTON. They originally built it.

Mr. SKELTON. They had built this same thing before?

Mr. SUTTON. Yes, sir.

Mr. SKELTON. Is that correct? So, the Air Force put out a bid for the same thing, and you wanted to compete with the Davey Compressor Co. or whoever makes it, but you can't get the specifications on how to build it.

Mr. SUTTON. That's right.

Mr. SKELTON. You don't know if it's 11 feet long or 11 inches long; is that correct?

Mr. SUTTON. That's right, sir.

Mr. SKELTON. Now, did you make a request of the Davey Compressor Co. for the specifications?

Mr. SUTTON. Yes, sir. I just went to a dead end each time.

Mr. SKELTON. What was the response from the Davey——

Mr. SUTTON. That it was proprietary information.

Mr. SKELTON. It was proprietary information. That was something they had developed themselves; is that correct?

Mr. SUTTON. Right. I asked them in developing this compressor, whose specifications did you use, yours or the Government's. They said the Government's.

Mr. SKELTON. They said the Government's. Were they more specific than that?

Mr. SUTTON. No, sir. At that time, he said too much. He quit talking to me.

Mr. SKELTON. Was it obvious to you that the Government had given them specifications and not you?

Mr. SUTTON. Well, yes. I don't know when the MC-11 compressor was first made, sir. I was only able to track it back through the computer to 1982. So, at least in 1982, they made 16 of them in 1982 and later years, they made 22. Not the compressors themselves, sir, but just the tanks.

Mr. SKELTON. All you wanted to do was compete with Davey Compressor, and there were specifications?

Mr. SUTTON. Right.

Mr. SKELTON. You were told they were Government specifications?

Mr. SUTTON. Yes, sir.

Mr. SKELTON. And, you were told this by the Davey Compressor Co. gentleman. Do you remember his name?

Mr. SUTTON. No, sir; I don't. I wish I did.

Mr. SKELTON. So, you were out on a limb, going nowhere, you didn't know whether to make a big tank or a little tank, a medium sized tank or a tall one or a skinny one or what.

Mr. SUTTON. Right.

Mr. SKELTON. Is that correct?

Mr. SUTTON. Right.

Mr. SKELTON. Now, you said somewhere in your testimony about the Eagle Air System. Is that part of the same conglomerate as the Davey Compressor operation?

Mr. SUTTON. Yes, sir.

Mr. SKELTON. Now, what about them? Did they end up doing something?

Mr. SUTTON. They ended up building this tank.

Mr. SKELTON. Oh, so, they built the tank.

Mr. SUTTON. Yes.

Mr. SKELTON. You think that these specifications were given to the Eagle Air System?

Mr. SUTTON. Well, I said they are the same conglomerate.

Mr. SKELTON. You think they had the specifications?

Mr. SUTTON. Oh, yes, sir.

Mr. SKELTON. Where do you think they got them?

Mr. SUTTON. From Davey.

Mr. SKELTON. All right. But, they wouldn't give them to you?

Mr. SUTTON. No, sir.

Mr. SKELTON. You were unable to submit any kind of a bid?

Mr. SUTTON. No, sir.

Mr. SKELTON. A big, little, fat, or any kind of a thing; is that right?

Mr. SUTTON. That's right.

Mr. SKELTON. You have had the opportunity to bid Government contracts before?

Mr. SUTTON. Yes, sir.

Mr. SKELTON. Have you won contracts?

Mr. SUTTON. Yes, sir.

Mr. SKELTON. So, your complaint is that you complied with the law as much as you could, but they wouldn't give you the specifications so you could actually make a bid? You didn't make a bid on this, did you?

Mr. SUTTON. Oh, no.

Mr. SKELTON. Is that correct?

Mr. SUTTON. Could not.

Mr. SKELTON. As you correctly point out, part of the law says a clear description of the property, supplies and services to be contracted for, which description is not unnecessarily restrictive of competition. Do you think that could have been complied with by the Air Force?

Mr. SUTTON. I think it should have been.

Mr. SKELTON. Do you think it could have been?

Mr. SUTTON. Yes, sir; it could have been.

Mr. SKELTON. From what they knew, from what they needed, they could have supplied you with the dimensions and drawings and needed pressures and all this, you think they could have done that?

Mr. SUTTON. Right.

Mr. SKELTON. Well, what was the reason given that they did not give it to you, sir?

Mr. SUTTON. Other than the fact that I was told it was proprietary information once. There was no time to backward engineer it.

Mr. SKELTON. What about this time business? It sounds to me, from what you're saying, that to comply with the law, they issued this request for bid just to get everybody off their back and to comply with the law, but they knew they were going to end up asking this one Davey operation to manufacture it. Is that what you're saying?

Mr. SUTTON. Yes, sir. I received the bid package, just to put a timeframe on it, on March 8. Negotiations for the contract were to begin on the 19th.

Mr. SKELTON. Of March.

Mr. SUTTON. Of March, yes, sir. They complied—not much time. So, with the specifications and drawings in our hands, and this is the type of thing that we build everyday, we would have been able to——

Mr. SKELTON. Well, I'll promise you one thing, we'll get an answer for you.

Mr. SUTTON. Thank you, sir.

Mr. SKELTON. I know Congressman Stenholm is fully aware of it. I will act as a member of the Armed Services Committee as well as a member of this committee. It concerns me a great deal as to why this came about.

Mr. Shelby?

Mr. SHELBY. Yes, sir?

Mr. SKELTON. I'm concerned about your testimony regarding the FTC. Are you saying the FTC is not doing its job?

Mr. SHELBY. On this sort of thing in this discrepant pricing, they are just paying no attention. We have hollered and we have asked for help; we have gone to the Supreme Court twice. It doesn't do any good. These drug companies are just doing as they please, and the pricing to wherever they think—they start with the patient in the hospital on the product, then they'll get the prescriptions and make the profit on the rest of it and make us look bad.

If they can sell it for $1 per package of 30 to the hospitals, there is something out of line when they sell the same product to us for $28 to $30 per box.

Mr. SKELTON. They're a little different color, aren't they?

Mr. SHELBY. No; the same package.

Mr. SKELTON. Awhile ago you said something about different types of colors.

Mr. SHELBY. Well, actually, that was in the same company in the generic pricing when we tried to establish a budget like Austin's, for our welfare, and we have a State law here which is in many, most States now, where if the doctor writes the product for—can be—product selection permitted, then we can go to the—our choice of whatever generic house we have, provided we can find a quality company, and this company that Ciba-Geigy has, Geneva Generic, is a quality company.

One of them will sell $2 a 100, the other will sell for $18 a 100. Same identical quality, same company makes both, and if we're—like, for instance, in our welfare, we can fill a prescription for $2, otherwise, we can sell it for $18, depending on how the doctor writes it, or if it's mandated from the budget, we can go the lower amount.

Oftentimes you hear of where the wheat starts out for what the finished product on the bread is, and what it costs, well, this is when the same company is making both products, and they are charging $2 one way and $18 another. It's the same company that's doing this.

That to me, either way I can go. I've got both products in stock, but this past deal is an example of what is happening in the market with the manufacturers, and it's not a volume deal.

Mr. SKELTON. Mr. Stenholm? Mr. Vandergriff?

Mr. VANDERGRIFF. Just one after thought. I believe you said in your testimony, Mr. Shelby, that you have knowledge that hospitals have sold drugs at a discounted price to pharmacists.

Mr. SHELBY. Sir?

Mr. VANDERGRIFF. Have you ever tried to do that?

Mr. SHELBY. No, sir.

Mr. VANDERGRIFF. I see. But, you know it exists and you know it has happened?

Mr. SHELBY. Yes, sir, it exists. We can find—if we were allowed or if we wanted to, it can be done. My testimony is not only my opinion, but it's from my Texas Pharmaceutical Association out of Austin, and we're working together on this. In fact, there's going to be legislation passed at our convention and probably lawsuits followed up on this sort of thing, that's maybe going to go clear on to another court case. I don't know.

By the way, Mr. Chairman, I would like to have inserted in the hearing record some comments by colleagues of mine, if possible.

[The comments referred to above follow:]

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July 16, 1984

Congressman Charles W. Stenholm
Rm 1232, Longworth HOB
Washington, D.C.

Dear Congressman Stenholm:

Reference the July 11, 1984 hearing in Albileen, Texas on small administration and specifically economics problems facing the independent pharmacists of the nation, Lex Shelby, R.Ph. has asked that I forward the enclosed for inclusion into the congressional record as part of his testimony.

For the past 14 years PPSI has been corresponding with the Federal Trade Commission on these economics issues that are threatening the future existence of the independent pharmacist. Copies of our most recent correspondence is enclosed.

We wrote to President Reagan in sheer desperation and received a response from Bryce Harlow, June 11, 1984 (enclosed). As is indicative of all the FTC responses "they are looking into it".

We appeared before the U.S. Justice with our proposed business review letter and for the lifting of the Consent Decree in Northern California Pharmaceutical Association v. U.S. Justice in order for pharmacists to negotiate for reimbursements for professional services.

Under the PPOs and the contracting that insurance companies now have it is impossible for pharmacists to negotiate reimbursements except unilaterally and as insurance companies will not negotiate with the independent pharmacist we are at a disadvantage. To further compound the problems manufacturers sell to hosoitals, HMOs, and chain pharmacies on a preferential basis but refuse to negotiate these same prices to the independent pharmacist even though we have offerred to purchase in the same quantity.

In summary, it's time for the federal and state governments, insurance companies, third-party fiscal intermediaries, and bureaucrats to stop trying to balance the increase in health-care dollars and budget on the backs of the small business man - the independent pharmacist. Will you please intercede on our behalf.

Sincerely,

Frederick S. Mayer
President

encl
cc:
Congressman Ike Skelton, Congressman Tom Vandergriff, Lex Shelby, R.Ph. Bill Morgan, R.Ph., John Carson, R.Ph., Martin Rubin, R.Ph.

pharmacists planning service inc.

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May 1, 1984

The Honorable
J. Paul McGrath
Assistant Attorney General
Antitrust Division
Department of Justice
Washington, D.C. 20530

RE: Request by Pharmacists Planning Service, Inc. for Business Review Letter Pursuant to Title 28 C.F.R. §50.6

Dear Mr. McGrath:

This is a request for a business review letter under the Department's antitrust business review procedure pursuant to Title 28 C.F.R. §50.6.

Since 1963, pharmaceutical associations and their members have been prohibited from jointly fixing prices of prescription drugs sold by association members, from formulating and distributing prescription drug pricing schedules, from urging or influencing members to adhere to pricing schedules, and from contacting individual members to fix prices. Consent Decree, United States v. Northern California Pharmaceutical Association, 1963 Trade Cas. (CCH) 70,690 (N.D. Cal. 1963). At the same time, during the last decade, there has been a significant increase in third party insurance programs offering some kind of prescription drug benefit which engage in the type of conduct prohibited to pharmacists by the 1963 consent decree. These third party plans have, for the most part, adopted arbitrary and stabilized fee levels that are offered to individual pharmacies on a "take-it-or-leave-it" basis. Yet cases brought by individual pharmacies against third-party providers on conspiracy and price-fixing theories have been, to date, unsuccessful in the federal courts. See, e.g., Sausalito Pharmacy, Inc. v. Blue Shield of California, 544 F. Supp. 230 (N.D. Cal. 1981), aff'd, 677 F.2nd 47 (9th Cir. 1982), cert. denied.

The price-fixing system practiced by third party providers has already done irreparable harm to the community pharmacy, forcing many independent pharmacies out of business, and many more to operate with minimal margins of profit. As a result, pharmacists are now among the lowest paid professionals, as are their employees. Due to the Consent Decree in Northern California Pharmaceutical Association, independent pharmacists are prevented on antitrust grounds from banding together to negotiate with the economically powerful third party providers.

Unilateral negotiation between independent pharmacies and third party providers has proved to be futile. Enclosed are letters from Royal Hills Pharmacy between insurance companies and other third party providers, requesting an increase in fees. As this documentation demonstrates, pharmacist Ed Hasson of Royal Hills Drug was told by Blue Cross of California that

> "our dispensing fee allowances are set based on a review of prevailing allowances listed in a quarterly survey supplied to us by PCS."

Enclosed is a copy of the PCS Professional Dispensing Fee Coded Survey which represents fees offered by carriers or sponsors having a substantial amount of business in the states where the fee is shown. As this list of fees and the correspondence between Mr. Hasson and Blue Cross of California and the Prudential Insurance Company demonstrates, the third party providers are setting prices for prescription drugs and dispensing services, yet under the Consent Decree, independent pharmacists are prevented from collective action in order to negotiate effectively with these corporate giants.

In its request for a business review letter dated April 10, 1969, PCS represented to the Department of Justice that

> "PCS does not contemplate inviting or acquiescing in any concerted action or permitting its facilities or lists to be utilized by pharmacists or their associations to take action which would result in fees for pharmaceutical services being either stabilized or fixed. Similarly, PCS does not contemplate inviting or acquiescing in any concerted action or activity by carriers or other purchasers of pharmaceutical services which would result in fees for pharmaceutical services being stabilized or fixed. Neither does PCS intend or contemplate meeting jointly with pharmacists or organizations representing pharmacists, or jointly with carriers or representatives of carriers, to establish compensation levels for pharmacists or to consult or advise, in either instance, on establishment of fee levels or amounts."

Letter from Robert F. Stevens, General Counsel, Pharmaceutical Card System, Inc. to The Honorable Richard W. McLaren, April 10, 1969 at pages 2-3. Yet it is clear from the correspondence from the insurance companies to Mr. Hasson that PCS is indeed fixing prices, and that fees for pharmaceutical services have become stabilized. See attached lists of dispensing fees set by PCS over the past several years, and note the average price of $3.60, which has not increased in the past four years.

Chain drug stores, non-profit and profit hospitals and HMO's are, in most instances, large enough to negotiate successfully with third parties such as PCS. However, independent pharmacies are being forced out of business because they are not allowed to bargain with the third party payers on a collective basis, but only unilateraly.

The insurance companies justify their price-fixing as "cost-containment" but in fact, what is happening is cost shifting, whereby the pharmacy must charge private patients more in order to make up for the lack of profit on prescription drugs provided to insured patients. In other words, non-insured patients are subsidizing the insurance companies "cost containment" programs.

Another problem encountered by the independent pharmacist in predatory pricing by the major drug manufacturers, who sell at "special prices" to large drug store chains and, increasingly, to hospitals that are operating out-patient pharmacies. Thanks to the lower prices these entities pay for drugs they can sell to the public at vastly lower prices than those charged by the independents. If the independents were able to negotiate collectively, they, too, could obtain "special prices" now available only to their largest competitors. An independent pharmacist, Reynaldo Guerra has recently filed suit in federal district court in Fresno, California,

against a non-profit community hospital and two drug wholesalers on the Robinson-Patman issue, but it may take years before Mr. Guerra gets any relief through this court action. The Federal Trade Commission has, for the past fourteen years, turned deaf ears to our complaints of predatory pricing.

Pharmacists planning Service, Inc., a non-profit 501(c)(3) organization, requests the following action from the Antitrust Division of the Department of Justice:

1. A review of current policy based on the information provided in this letter and on any further information requested by the Department;
2. The lifting or modification of the Consent Decree in United States v. Northern California Pharmaceutical Association; and
3. Recognition for Pharmacists Planning Service, Inc. as a preferred provider organization (PPO) for the purpose of setting professional standards and negotiating fees as presently done by PCS and Blue Cross.

Independent pharmacists have brought these issues to the attention of the Federal Trade Commission and to the courts, but have not received any relief. Therefore, we turn to the Department of Justice as our last hope before the independent community pharmacy is forced out of business by price-fixing and predatory pricing of the insurance companies and drug manufacturers, against whom the independent pharmacist connot compete unilaterally.

I will be in Washington on May 21-23 and would greatly appreciate an opportunity to meet with you and your staff to discuss this letter and its enclosed documentation. In the meantime, if you require further information, I would be happy to provide the same to you.

Sincerely,

Frederick S. Mayer
President

encls.
cc: Steven B. Kramer, Esq., Antitrust Division

U.S. Department of Justice

Washington, D.C. 20530

12 JUN 1984

JPMcG:JWP:SBK
60-423-0

Mr. Frederick S. Mayer
P.O. Box 1336
Sausalito, California 94966

Re: Request for Business Review Letter

Dear Mr. Mayer:

With the benefit of having met with you on May 21, 1984, I am writing this letter in response to your May 1, 1984, request for a business review letter. I hope this will provide you with some guidance in the nature that you requested at our meeting.

In your letter, you requested three courses of action from the Antitrust Division:

1. A review of current policy based on the information provided in this letter and on any further information requested by the Department;

2. The lifting or modification of the Consent Decree in United States v. Northern California Pharmaceutical Association; and

3. Recognition for Pharmacists Planning Service, Inc. as a preferred provider organization (PPO) for the purpose of setting professional standards and negotiating fees as presently done by PCS and Blue Cross.

After reviewing the information you sent on May 1, 1984, and speaking with you on May 21, 1984, we understand your first request to be that we open an investigation into alleged price fixing by third-party payers who purchase prescription drugs

and dispensing services. In our view, the information that you have provided in support of your contentions is insufficient to warrant a recommendation to open such an investigation. At our meeting, I explained our reasoning.

Your second request for termination or modification of the consent decree entered in United States v. Northern California Pharmaceutical Association is unsupported by any specific proposed modification or by any reason for termination or modification. If you wish a decree termination or modification, you must supply this basic information for our consideration. I might add that your third request appears to implicate a modification of some nature.

Only your third request approaches the nature of a business review request contemplated in federal regulation 28 CFR §50.6. The problem with your request as it stands is that it gives us insufficient information concerning the background and structure of Pharmacists Planning Service, Inc. or the scope of the activities that you are contemplating. Before we are able to consider your request we shall need this information. I suggest that you review paragraph 5 of 28 CFR §50.6 for guidance. To provide additional guidance, I have also enclosed copies of two recently submitted business review requests concerning PPOs and the two resulting business review letters.

If you have any questions, please feel free to contact me.

Sincerely yours,

Steven B. Kramer

Steven B. Kramer
Attorney
Antitrust Division

Enclosures

pharmacists planning service inc.

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Upland, PA

May 9, 1984

Karen G. Bokat, Attorney
Bureau of Competition
Federal Trave Commission
Washington, D.C. 20580

Dear Karen:

I'm sorry due to your prior committment we will not be able to get together when I'm in Washington.

Thank you for the duplicate copy of your April 23, 1984 letter and I am enclosing at this time another one that probably also crossed in the mails dated May 1, 1984 addressed to Michael Goldenberg, Esq. In that letter I made reference to a microfisch which did not get included. Hence I send it to you now.

Do you think that we could get together with Michael or Norman during our visit in that you will not be available?

I have sent you during the past month the following:

1) Reynaldo Guerra v. Corcoran Drug Store case.
2) Charles Shoopman, Porterville, CA. problems with chain stores.
3) Comp-U-Card mail order program with differential pricing by Rush Presbyterian-St. Luke's Medical Center, Chicago.

Enclosed please find at this time the law suit filed by our member Richard Reedal, Home Parenteral Care, Inc. v. Sacred Heart General Hospital.

Karen, we have been communicating with you and your department now for the past 9 years and todate have heard nothing as to the status of this situation. You referred in your last two letters that you have been referring our communications to the FTC Bureau of Economics. Should we be communicating directly with them? can we meet with them while in Washington? Is there a specific person in that department with whom we can communicate?

We are aware of the FTC's decision regarding the funeral parlors methods of selling caskets which took 13 years. We the pharmacists are getting close to the 14 year mark -- how much longer do we have to wait?

Please let me hear from you.

Sincerely,

Frederick S. Mayer
President

encls.
cc:

Bureau of Competition
FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

May 4, 1984

Mr. Frederick S. Mayer
President
Pharmacists Planning Service, Inc.
200 Gate Five Road
P. O. Box 1336
Sausalito, California 94966

Dear Mr. Mayer:

On May 2, 1984 I received your letter of April 23, 1984, which must have crossed my letter of the same date. I thank you for bringing the views of Mr. Morgan to our attention. I will send a copy of his letter to our economist who is analyzing the problem of discriminatory prices of pharmaceuticals. I regret that I will not be able to see you when you are in Washington this month. Enclosed is a copy of my April 23, 1984 letter to you in case the original was not delivered.

Sincerely

Karen G. Bokat

Karen G. Bokat
Attorney

Enclosure

pharmacists planning service inc.
200 GATE FIVE ROAD PO BOX 1336 SAUSALITO, CA 94966 (415) 332-4066

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May 9, 1984

Karen G. Bokat, Attorney
Bureau of Competition
Federal Trave Commission
Washington, D.C. 20580

Dear Karen:

I'm sorry due to your prior committment we will not be able to get together when I'm in Washington.

Thank you for the duplicate copy of your April 23, 1984 letter and I am enclosing at this time another one that probably also crossed in the mails dated May 1, 1984 addressed to Michael Goldenberg, Esq. In that letter I made reference to a microfisch which oid not get included. Hence I send it to you now.

Do you think that we could get together with Michael or Norman during our visit in that you will not be available?

I have sent you during the past month the following:

1) Reynaldo Guerra v. Corcoran Drug Store case.
2) Charles Shoopman, Porterville, CA. problems with chain stores.
3) Comp-U-Card mail order program with differential pricing by Rush Presbyterian-St. Luke's Medical Center, Chicago.

Enclosed please find at this time the law suit filed by our member Richard Reedal, Home Parenteral Care, Inc. v. Sacred Heart General Hospital.

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Please let me hear from you.

Sincerely,

Frederick S. Mayer
President

encls.
cc:

FEDERAL TRADE COMMISSION
WASHINGTON, D.C. 20580

OFFICE OF
CONGRESSIONAL RELATIONS
(202) 523-3820

June 11, 1984

Mr. Frederick S. Mayer
President
Pharmacists Planning Service, Inc.
200 Gate Five Road
Post Office Box 1336
Sausalito, CA. 94966

Dear Mr. Mayer:

This is in response to your letter to President Reagan dated April 25, 1984, which was forwarded by the White House to the Federal Trade Commission. In your letter, you urge action by the Commission to assist independent pharmacists who compete with non-profit organizations. Your letter and attachments allege that these non-profit organizations purchase drugs at discriminatory prices and that because of this cost advantage, independent pharmacies cannot compete against the non-profit organizations.

I have consulted with appropriate members of the Commission staff about your concerns. The Commission is responsible for enforcing the Robinson-Patman Act, 15 U.S.C. 13, which makes it unlawful under certain circumstances for a supplier to discriminate in price between different purchasers where the discrimination may result in a substantial lessening of competition. The fact that a supplier is charging different prices to different purchasers in itself does not necessarily constitute a violation of the antitrust laws. For an antitrust violation to result from a price differential such as that described in your letter, there must be contemporaneous sales of commodities of like grade and quality, and there must be a substantial probability that the effect of the price differential may be substantially to lessen competition in a line of commerce, to tend to create a monopoly, or to injure, destroy or prevent competition.

The information you provided has been given to the members of the staff who are studying the issue of competition between private firms and tax-subsidized nonprofit institutions, and the extent to which the tax-exempt status of the latter may confer an anticompetitive advantage. Thank you for bringing this information to the attention of the Commission. Please let me know whenever we may be of service.

Sincerely,

Bryce L. Harlow
Director

RESOLUTION NO. ____

"Discriminatory Pricing"

WHEREAS, discriminatory pricing is recognized as one of the most divisive forces working against the unity of the pharmacy profession today, and is actually pitting independents against chains, and chains against hospitals, and for-profit hospitals against non-profit hospitals, and all of these against pharmaceutical manufacturers, and

WHEREAS, the Robinson-Patman Act clearly defines these practices, as we know them to be carried on today, as being illegal, and

WHEREAS, for whatever political reasons, the Justice Department and the Federal Trade Commission, are not enforcing these provisions of the Robinson-Patman Act, and

WHEREAS, these practices are making it extremely difficult to remain a viable force in the marketplace, due to the unfair price advantage that some competitors have over others for no other reason than they have acquired their merchandise 40% to 60% cheaper than their less fortunate colleagues, and

WHEREAS, there seems to be a proliferation of these so-called Co-ops or buying groups, all of which are illegal according to the strictest interpretation of the Robinson-Patman Act, and

WHEREAS, fair competition is recognized as being one of the cornerstones of a free market place, and unfair competition is one of the worst detriments to a free market, and

WHEREAS, equitable treatment for all pharmacists by our suppliers, whether manufacturers or wholesalers is essential if they are to be able to compete with the larger organizations that profess to serve the same group of consumers, and

WHEREAS, it would be to the best interest of all pharmacists if Pharmacy were treated and looked upon as a profession, and not a loss-leader by those of our colleagues who want the consumers to judge our services only on the basis of price, and

WHEREAS, the public would be better served in a atmosphere where a pharmacist could make his first consideration how well he could serve his patients, and NOT how CHEAP he could do it. Therefore, be it

RESOLVED, that the Texas Pharmaceutical Association, either alone, or with a coalition of other state or national assocations, i.e., TSHP, ACA, NARD, APHA, etc, take legal action through the court system and file a large class-action suit against one or more drug manufacturers that we can prove the most cases of discriminatory pricing, and be it further

RESOLVED, that if present legal-counsel cannot pursue this issue because of other legislative issues before the association this legislative year, that outside counsel be hired as soon as possible, and action be started as soon thereafter as possible, and be it further

RESOLVED, that this matter be put in the capable hands of the Board of Directors of the Texas Pharmaceutical Association to maintain a continuing vigilance on the progress of this issue as it proceeds through the court system, and therefore be able to keep the membership advised of its progress.

Respectfully submitted,

Mid-Coastal Pharmaceutical Association

AT ISSUE

Can PPOs be beneficial to pharmacy?

A preferred provider organization, a form of contract health care (see page 48) whereby providers bring services at reduced rates to members of a third-party plan on a preferred basis, is regarded within pharmacy as both a blessing and a curse. Here are two views.

Preferred provider organizations (PPOs) are an integral part of the new wave sweeping through the health delivery system in America. Many pharmacists, perhaps with good reason, are frightened by this new movement, while others see it as an opportunity to expand professional roles.

Whatever one's outlook may be with respect to the incoming tide of health-care organizations, one thing is for certain—it's not going away.

Most health-care providers do not realize that there is a revolution occurring in the health-care delivery system in this country, and it is largely due to the efforts of the private sector to reduce the cost of health-care premiums.

Point:
Robert C. Johnson
is executive vice president of the California Pharmacists Association and was a strong contender for the post of president of APhA

Large businesses that absorb a significant amount of health-care costs in order to provide these benefits to their employees have rebelled at the annual increases they are expected to pay. Consequently, they have sought to reduce these costs by means of negotiated rates with providers. Thus, through the efforts of the business/labor coalitions and the health insurance industry, provider networks are being organized to ensure a health manpower pool adequate to serve employee needs at a negotiated rate.

As PPOs proliferate, pharmacists will be faced with many problems and, unfortunately, little has been done to properly educate business or the insurance industry in dealing with these problems.

The most overriding issue facing both physicians and pharmacists is that of the antitrust laws. The U.S. Supreme Court's Mariposa decision implies that health-care providers cannot collectively negotiate fees or rates for their services; this prevents groups of pharmacists or doctors from negotiating rates with an insurance company or employer.

Little if any attention has been given to this problem by the national associations in pharmacy—leaving it up to the state associations to fend for themselves. The California Pharmacists Association has retained a respected law firm to address the antitrust situation and has also met with Congressional leaders to explore modification of the antitrust laws so as to permit health professionals

Insurance companies, fiscal intermediaries, labor unions, health maintenance organizations, and for-profit and nonprofit hospitals should not be allowed to negotiate for and set up preferred provider organizations and exclusive provider organizations (EPOs); nor should they be allowed to negotiate fees and reimbursement rates for pharmacy.

Even though state legislators and government officials have been stressing that the cost of pharmaceutical services must be contained and that taxpayers will no longer pay for the rising costs of health care, pharmacy cannot stand by and allow the elimination of freedom of choice for their patients and the elimination of the small-business man.

Counterpoint:
Joseph I. Rotenberg
is owner of Joe's Pharmacy, San Francisco; vice president, PPSI; and director, San Francisco Pharmacy Association

Pharmacists must understand there are several varieties of PPOs. In the voluntary type, patient participation is encouraged through such inducements as lower copayments or deductibles, or higher benefit levels; in the exclusive provider organization, patients are restricted in their choice of provider.

PPOs artificially restrict competition among providers by designating specific pharmacies for plan participants to patronize, raising the specter of pharmacy monopolies. Since 1963, pharmaceutical associations and their members have been prohibited from jointly fixing prices of prescription drugs sold by association members, from formulating and distributing prescription drug pricing schedules, from urging or influencing members to adhere to pricing schedules, and from contacting individual members to fix prices.

At the same time, unilateral negotiation between independent pharmacies and third-party providers has proved to be futile, and the price-fixing system practiced by third-party providers and insurance companies has already done irreparable harm to the community pharmacy, forcing many independent pharmacies out of business.

Chain drugstores, nonprofit and for-profit hospitals, and HMOs are, in most instances, large enough to negotiate successfully with PPOs and EPOs. But by law, independent pharmacists cannot negotiate price as a group with the PPOs and EPOs, which are being touted under the guise

Johnson *continued*

to participate in group provider organizations.

Because of the antitrust impediments to group negotiation, business employers and insurance carriers have sought contracts with chain pharmacies. Since a chain is under single ownership, it can negotiate a rate and give assurance that each of its outlets will participate in a contracted program. Here again, however, the purchasers of pharmaceutical services have not been adequately informed about the adverse effects of limiting accessibility to pharmacy services. If the employee or beneficiary is required to travel some distance to obtain a drug or have a prescription refilled, studies show, he or she is less likely to obtain the needed medication and thus often requires hospitalization as well as additional physician attention.

> "The first thing pharmacists must do is overcome their fear of PPOs—the large purchasers of health care are going to insist on [them] . . ."
>
> **Johnson**

This leads to the potential opportunities afforded by the PPO movement. Pharmacists, indeed, are in a unique position to offer comprehensive care beyond dispensing medication. They can play a role in reducing overall costs through the following means:

- Maintain patient medication profiles and monitor drug regimens to ensure compliance.
- Participate in a meaningful drug utilization review system that will ensure prescribing of the most appropriate cost-effective drug.
- Educate patients to the proper use of drugs and the importance of nutrition, diet, and exercise, and provide advice on OTC medications that may reduce the need for prescription drugs.

Indeed, there are many means for professionally motivated pharmacists to participate as preferred providers. However, pharmacists must make an effort to seek out these employer groups in the community to inform them of the need for the abovementioned services that *only* pharmacists can offer. Additionally, pharmacists must insist on reasonable but adequate remuneration for their services.

Perhaps the first thing pharmacists must do is overcome their fear of PPOs—the large purchasers of health care are going to insist on their continuance, at least until some other means of reducing health-care costs can be found.

Second, instead of burying their heads in the sand and hoping PPOs will go away, pharmacists must work through their professional associations to seek the most appropriate means of participating and obtaining adequate reimbursement for the comprehensive service they can provide.

Whether the curse can be converted to opportunity is largely dependent upon the effort that pharmacists and their associations undertake in this challenging decade of the '80s. DT

Rotenberg *continued*

of cost-containment. Do you see something inherently wrong with our system of justice?

Another problem encountered by the independent pharmacist in lowering the cost of pharmaceuticals and bidding for EPO and PPO participation is the pricing system of the major drug manufacturers, who sell at special prices to large drugstore chains and, increasingly, to hospitals that are operating outpatient pharmacies. In *Jefferson County (Alabama) Pharmaceutical Association v. Abbott Laboratories*, it was ruled last year that state hospitals are not exempt from the antitrust laws when they buy drugs at favorable rates and sell them to outpatients. Nonetheless, as this case and *Portland Retail Druggists Association v. Abbott Laboratories* wind through the courts, pharmacists are still not able to sell to the public at vastly lower prices than those charged by hospitals/HMOs.

Where 72% of the Rx cost is the cost of the actual drug ingredient and 28% is the professional fee, independents are obviously at a disadvantage when they try to lower the cost of health care by reducing further the cost of pharmaceuticals.

PPOs and EPOs rationalize their practice of lowering health-care pharmaceutical costs by contracting with the lowest bidder on a unilateral basis. However, what is happening in essence is a *cost shifting;* in other words, those patients who are not part of a prepaid health plan or PPO are subsidizing the insurance companies' "cost-containment" programs.

> "By law, independent pharmacists cannot negotiate price . . . with the PPOs and EPOs, . . . touted under the guise of cost-containment."
>
> **Rotenberg**

PPOs and EPOs will prove to be the demise of the community pharmacy as we know it today, unless the following steps are taken by organized pharmacy:

- We must have a lifting of the consent decree in *United States v. Northern California Pharmaceutical Association*, so that pharmacists can negotiate as a group.
- Predatory pricing must be eliminated or made available to the independent pharmacist so that he/she can compete in the marketplace.
- The federal government must intercede against the insurance companies to prevent antitrust violations and force them to negotiate fairly with independent pharmacists.

In summary, it's time for the federal and state governments, insurance companies, third-party fiscal intermediaries, and bureaucrats to stop trying to balance the increase in health-care dollars and budget on the backs of pharmacists. Pharmacy has been cost-contained since 1967 and continues to be the most cost-effective service in the health-care industry. We stand at the crossroads: We will either stand up and fight or succumb to Big Brother. DT

Mr. VANDERGRIFF. Fine. Thank you very much.

Mr. SKELTON. Thank you, gentlemen. I appreciate your appearance before us today. We are on time. I compliment you as well as my colleagues.

We will now proceed to panel 2. Thank you again. Remember your 5-minute limitation. We begin with Till Phillips. Please state your name, your address, and your occupation, please.

TESTIMONY OF TILL PHILLIPS, DEPUTY REGIONAL ADMINISTRATOR, SMALL BUSINESS ADMINISTRATION

Mr. PHILLIPS. Mr. Chairman, Congressman Vandergriff and Congressman Stenholm, it's a real pleasure to be able to appear before the committee here today representing the Small Business Administration region VI, which encompasses the five-State area.

I am Deputy Regional Administrator for region VI. Our office is located in Dallas, TX. The hearings here today will give us an opportunity to speak to you concerning particularly our loan programs. We do have a statement we'd like to enter into the record to be presented by Mr. Hall Martin, who is seated to my left, and I would like him to be able to present that, sir.

Mr. SKELTON. Please be seated, Mr. Martin.

Mr. MARTIN. All right.

TESTIMONY OF HALL T. MARTIN, ASSISTANT ADMINISTRATOR FOR FINANCE AND INVESTMENT, SMALL BUSINESS ADMINISTRATION

Mr. MARTIN. Thank you, Mr. Chairman. It's a personal pleasure to be here this morning, and with your permission, I would like to submit this statement in the record and with your further permission, I would like to just summarize the statement and then move on.

Mr. SKELTON. Please proceed.

Mr. MARTIN. All right, sir. Thank you.

As Mr. Phillips said, we appreciate the opportunity to appear before your committee today to discuss the U.S. Small Business Administration loan programs, and ways in which the SBA can be of assistance to the small business people in this area and the State of Texas, and specifically region VI.

By way of background, region VI of the Small Business Administration covers approximately 560,000 square miles and some 26 million people. Today, we are going to dwell primarily on the Dallas district and the Lubbock district, and you'll hear more about that later. Mr. Darby, is the area director of the disaster office.

The regular business loan program, which is our basic program, authorized under section 7(a) of the Small Business Act allows the small business concern to receive a loan for working capital, debt payment, purchase of inventory, equipment and so forth. The limitations are on a direct loan of $150,000. The guaranteed loan, $500,000, with a maximum guarantee of 90 percent.

The criteria: funds must not be available otherwise, good character, repayment ability, and reasonable equity in the business. The maximum maturity is 25 years. The current rate is on a formula basis, and the maximum direct rate is 14 percent.

We have a size standard and, of course, the small business concern must be eligible by that standard. For the 6-month period ending March 1984—region VI made up of 10 districts, we have approved 168 direct loans in the amount of $13.3 million and 939 guaranteed loans in the amount of $141.6 million.

Of that amount, approximately 27 percent or $38.8 million has been directed to small business concerns in the Lubbock and the Dallas districts. There is an increase in popuiarity throughout the region of the certified lender program whereby we have 72 banks that are certified lenders now, and this is a program whereby we put more reliance on the banks. They do more of the work and, thus, leverage our resources.

Over 75 percent of the banks in the region do participate with us. That pretty well covers the 7(a) loan program as outlined there. The program I would like to spend a couple of my 5 minutes on is what Mr. Sanders, our administrator, calls the flagship program. That's the certified development company program, whereby we make a loan to a development company which in turn assists the small business concern.

This program was passed by Congress about 1979 or 1980, and came on stream. It's a job creation program that has limitations from the standpoint of the use of funds. We might just talk about that in that we have three certified development companies in Lubbock. Actually, we have four now as of March 31. We had three. We now have four with the advent of Midland coming in, and there is a group in Big Springs, TX, that should soon be approved for a certified development company.

The Dallas district has about 11 certified development companies, and the beauty of this program is we get lots of leverage for the limited Government money that goes into the programs. Through March 1984, in the 10 districts, we produced 60 loans for a total debenture guarantee of about $10 million. Lubbock and Dallas have collectively produced 24 loans during the period or about 40 percent of all the 503 loans made to the certified development companies were made in the Lubbock and Dallas areas.

The disaster loan program Mr. Darby will cover later, as outlined in the statement, and I would just like to end up by talking about our philosophy in the SBA concerning our lending programs.

The emphasis today is on making quality loans versus the quantity of loans that have gone on in the past. Numerical goals in loanmaking activities have been abolished, although we are emphasizing quality loans, at the same time, we try to fulfill our role as a lender of last resort. Therefore, the businesses receiving SBA's financial assistance should be able to pay off their debts according to the amortization schedule and be spared failure due to their excessive debt.

The improvement in quality of lending and the time of the quality loan decisions is part of SBA's ongoing effort to streamline operations and better serve the small community.

Thank you for the opportunity to appear before your committee today, and at the appropriate time, I would be pleased to respond to any questions that you may have concerning our lending program. Thank you.

[Mr. Martin's prepared statement follows:]

PREPARED STATEMENT OF HALL T. MARTIN, ASSISTANT ADMINISTRATOR FOR FINANCE AND INVESTMENT, SMALL BUSINESS ADMINISTRATION

Mr. Chairman and members of the committee, I appreciate the opportunity to appear before this committee today to discuss the U.S. Small Business Administration's (SBA) loan programs and ways in which the SBA can be of assistance to small businesses in areas of community economic development.

Included in the handout material today is an outline and brief explanation of SBA programs. Before this committee today I will address SBA regular business loans, development company loans and disaster loans.

The regular business loan program under section 7A of the Small Business Act, allows a single small business concern to receive a loan for working capital, debt payment, purchase of inventory, purchase of equipment and construction purposes to be repaid over an extended term for better assurance of repayment ability.

Limitations—Direct, $150,000, guaranty participation up to 90%, $500,000.

Criteria—Funds not otherwise available, good character, repayment ability, reasonable equity.

Maturity—Up to 25 years.

Interest rate—14% direct loans (July 1, 1984) guaranteed loans, NY prime plus 2¼ under 7 years. NY prime plus 2¾ over 7 years. Interest rate with lender negotiable.

Eligibility—Subject to size standards—acceptable business.

Ending 3-31-84, region VI made up of ten districts has approved 168 direct loans in the amount of $13.3 million and 939 guaranteed loans in the amount of $141.6 million. Of the amounts, approximately 27% or $38.8 million has been directed to small business concerns in the Lubbock and Dallas districts. SBA guarantees to participating lenders exceed direct lending by approximately 90%. Increasing in popularity throughout region VI is the certified lenders program whereby frequent participants with SBA are certified to take on increasing responsibilities in loan processing, loan closing, loan servicing and loan liquidation. Out of 72 certified lenders in region VI, twelve are located in the Dallas and Lubbock districts. Plans are under way to further participating private sector lending with emergence of the preferred lenders program, a program giving deserving participating lenders almost universal loan approval and loan closing authority.

Development company loans, through section 503 of the Small Business Act providing long term fixed asset financing for small business concerns (SBC) primarily in the expansion state of development.

Limitations—A development company certified by SBA comprised of minimum 25 active participants, borrows funds from SBA and lender for reallocation to small business. Maximum 40% SBA injection not to exceed $500,000 in project through 100% debenture guarantee to Federal financing bank, Washington, D.C. for each identifiable small business concern.

Criteria—plant acquisition, construction, conversion, expansion, including acquisition of land and fixed machinery and equipment. Private sector lender furnishes first 50% cost of project in exchange for first mortgage. SBA furnishes 40% cost of project in exchange for second mortgage. Development company furnishes 10% cost of project in exchange for third mortgage. Reasonable interest rate of 1st mortgage required.

Eligibility—net worth of small business concern may not exeed $6 million. Two year average income may not exceed $2 million. Proceeds cannot be used for working capital or debt payment.

Through 3/31/84 region VI ten districts produced 60 loans for total debenture guarantees of over $10 million. Lubbock and Dallas districts collectively produced 24 loans during the period or 40% of development company volume. Fourteen out of fifty active region VI certified development companies are located in the Lubbock and Dallas districts. As you can see, the nothern districts of Texas are becoming aggressive innovators of community economic development.

The Disaster Loan Program provides loans under the Small Business Act, section 7(b)(1) and (2) to repair or replace damaged or destroyed property to pre-disaster condition, and to alleviate economic injury cause by diaster,

Limitations—personal property loans limited to $20,000; homeowners loans limited to $100,000 and business loans may not exceed $500,000.

Criteria—applicant must show repayment ability. Loan based on verified loss.

Maturity—maximum of 30 years: Actual maturities will be determined on a case-by-case basis. For businesses able to obtain credit elsewhere, maturity is limited to a maximum of 3 years.

Eligibility—any size business, homes, churches, charitable and nonprofit organizations, private schools, newspapers and T.V. purchase of federal flood insurance where appropriate. Eligibility for economic injury disaster loans is limited to small businesses unable to obtain credit elsewhere.

Interest rate—rate in effect at the time the disaster commenced. Unable to obtain credit elsewhere not to exceed 4% per year. Able to obtain credit elsewhere not to exceed 8% per year. Nonprofit organizations including churches and charitable organizations 10%.

The Dallas and Lubbock districts accounts for approximately 22% of disaster activity in region VI. Disaster loans are limited to $500,000 direct or physical and/or economic injury. Physical disaster loans have no size standard. If credit is available elsewhere, interest rates are 8%. If credit elsewhere is not available interest rates are 4%.

Mr. SKELTON. Thank you. Mr. Darby?

TESTIMONY OF GEORGE DARBY, AREA 3 DIRECTOR FOR DISASTER ASSISTANCE, SMALL BUSINESS ADMINISTRATION

Mr. DARBY. My name is George Darby. I'm area director for the Small Business Administration, Area 3 Disaster Program.

Basically, our program is activated by either the President or the Administrator of the SBA because of disasters, and I'm sorry I don't have any prepared text, but I'll certainly be happy to answer any questions that you may have.

Mr. SKELTON. Thank you. Mr. Reed?

TESTIMONY OF JAMES S. REED, DISTRICT DIRECTOR, SMALL BUSINESS ADMINISTRATION

Mr. REED. Yes. My name is James S. Reed. I'm district director of the Dallas district. Dallas district office services some 72 counties, which make up the northeast quadrant of Texas.

We have the responsibility of administering all the programs of the agency, and I didn't prepare a statement either.

Mr. SKELTON. Thank you. Mr. O'Jibway?

TESTIMONY OF PHILIP J. O'JIBWAY, DISTRICT DIRECTOR, SMALL BUSINESS ADMINISTRATION

Mr. O'JIBWAY. My name is Philip O'Jibway, district director of the Lubbock district, which encompasses the Panhandle area of Texas, Abilene or Taylor County being the southeast corner of our district.

We have 32 permanent employees that are servicing a portfolio of approximately $0.5 billion in both business loans as well as disaster loans in that area.

I do not have any prepared statement. I will be available to answer any questions related to activities in my district.

Mr. SKELTON. Thank you so much. We appreciate your brevity. We will have numerous questions for you.

Mr. Stenholm?

Mr. STENHOLM. Mr. O'Jibway, you say that your office is servicing over $0.5 billion outstanding in loans. We have read a lot of publicity recently in Agriculture from Farmers Home respective of how over half of the outstanding loans will be paid.

What is the record in your district and in this region, I might ask, right now, on the status of those loans as far as their being paid on time or not?

Mr. O'JIBWAY. We have approximately 7,500 farm loans that we classify in that same category with the Farmers Home Administration in our district. The currency rate on those 7,500 loans currently is running approximately 90 percent. Now, we do have to take into consideration the fact that a large percentage of those loans have been deferred for various and sundry reasons.

As long as that farmer has an opportunity to finance his current cropping operation and we have some assurance that he has a projection with his bank in terms of funding the debt that he's creating and at the same time at least pay interest on our loan, we will make a deferment on it.

During the peak period of the Farm Disaster Program, which started really about 1977–78, we had in our district probably the largest number dollarwise of farm disaster loans, and we haven't really had a normal crop here since that started, and as a result of it, we have had a lot of problems with a good many of the farmers servicing that debt.

With the use of the deferment process, that money has been decreased to approximately 50 percent. Our current dollar amount of debt on those disaster loans has been cut approximately in half since the inception of those loans. So, overall, I'd say that in spite of the adversity that has been in the ag economy out in this area, they have done an outstanding job of meeting their obligations.

Mr. STENHOLM. Do you have a foreclosure rate? What was your loss experience in 1983?

Mr. O'JIBWAY. No, I don't have those statistics. The information I have available right here is kind of a worksheet that we work on our individual loan officers, that are servicing these loans. I can't give you a liquidation number either in terms of dollars or numbers. I could give you some numbers, but that wouldn't really represent the true figures we'd have to get some information for you on the liquidation aspects of it.

Mr. STENHOLM. I would be interested in those numbers being submitted for the record and then to me personally.

Mr. SKELTON. Let me state that we will have our record open for 7 days, if you would be kind enough to submit those to us within those 7 days, we would appreciate it.

Mr. STENHOLM. Public Law 98–270, which was under the Budget Reconciliation Act of 1983, made SBA nonphysical disaster loan assistance available to businesses adversely affected by the peso devaluation as well as to certain agricultural cooperatives.

Those are the types of loan assistance that are of special interest to this part of the country. My question is, can any of you tell me when you expect to be able to accept applications for such loan assistance?

Mr. DARBY. Well, since all that's basically disaster, I guess I should answer that. My answer at this point is no, I really don't. I understand some of those regulations have been drafted, and are being submitted to OMB.

Mr. SKELTON. I might interrupt at this point. As you know, I was interested in that and had an amendment on this point this year. Counsel can answer your question if you'd like him to answer it right now.

Mr. ORBAN. Yes. For the record, we checked about 5 weeks ago and we checked again about 2 weeks ago with the Small Business Administration in Washington at their regulation division in their legal department. Even though regulations did exist for the non-physical disaster program, the administration felt it was necessary to draw new regulations. They maintain that this will take some time. As I understand it, these regulations have cleared the Small Business Administration, but they have been sent to the Office of Management and Budget where they are undergoing another review.

Finally, under the Administrative Procedures Act, they must be published for comment. The result of it is a longer delay and longer period of frustration for the farmers who need assistance.

Mr. STENHOLM. Of course, the major folks interested in that are the businesses, the small agribusinesses that were adversely affected by the peso devaluation. It would not only benefit many farmers, but many businesses that were adversely affected and that's the major concern there.

Mr. Reed, you or anyone on any of these questions, Mr. O'Jibway referred to the intertwining or marriage of FHA, FMHA, and SBA in recent years in many of these programs. You have been asked to get into areas normally served by the Farmers Home. What is your evaluation today of this marriage that has occurred over the last 4 to 6 years or since 1978, I think is when it really started? Is it working? Is it a harmonious marriage? Has it got problems? Is it a marriage that this committee ought to look at?

Mr. REED. Congressman, my relationship has been good, but I would defer that question to Mr. Darby, and I think he works with those people at FMA, FMHA on a continuous basis.

Mr. DARBY. Well actually we just got back into the farm business within the last year, and it's a Business Loan Program, and we are to treat farms as we would other businesses, and I think there is some difficulty in doing that inasmuch as a farm is a unique business.

The Farmers Home Administration Program is considerably different from the SBA Disaster Program. There have been some difficulties. I think the communication between the two agencies has been good, and I think basically what we try to do when there is a disaster is to counsel the farmer as to what this agency can do, Farmers Home counsels as to what their agency can do, and say these are the two programs, which best suits your needs.

In some instances, our program is better; in some instances, the Farmers Home Program is better. They are not the same program.

Mr. STENHOLM. It's been my personal opinion to separate the two as much as is possible. I agree with what you have said. They are separate agencies, and we ought to strengthen both programs and make them work more individually than marry them. But we seem to be going in the other direction again.

One final question, and I'll defer and then come back with a couple of others. To each of you now, in your experience aside from simply the availability of working capital, which is a problem for many of our small businesses, what would you say are the most prevalent problems which causes small businesses in this district,

in this area, in this region, to come to you? What are their problems, other than working capital.

Mr. DARBY. From a disaster point of view, the biggest problem that we have found in processing business disaster loans has been the fact that we have gone through so many years of high interest rates, it's drained their working capital and that really has been their big problem. There's a good recovery rate going on now from, you know, what we see. Of course, we only see them for disasters, and I'm sure Mr. Reed could give you a better idea about the other program.

Mr. REED. Well, Congressman, I would say, of course, we meet the multitude of problems with the small business people that we deal with on a one-to-one basis. But, the problems that the small business people face, certainly in the eastern part of the State, I think probably are pretty much the same as they are across the country. Each one is on his own, and each one invariably is in need of management assistance, and we provide a tremendous amount of counselling to small business people and all across that district.

I wouldn't say, other than a lack of preparation for initially going into business, there is one singular problem. For awhile—when the rest of the Nation was in an economic recession in the latter part of 1982 and 1983, the Metroplex area did not suffer to the same extent as some of the more rural areas in our district.

During that period, our bankruptcy rate was higher in the rural areas. The Metroplex has been blessed with a very balanced economy, and it seems to chug right on through that dip that the rest of the country took. I would say that problems of the small business people are pretty much the same across our 72 counties as they are everywhere.

Mr. O'JIBWAY. In the west Texas area, one of the primary problems with a good many businesses and I would assume it is probably one of the largest problems, is the spreading of debt load over a long enough period so they can service it from net profit.

I think a good many of our businesses are servicing their debts on a short-term note, and they are having difficulty meeting those obligations on a timely basis. If there was someway they could spread that out, I think it would be a big help to them.

Mr. MARTIN. My response to that would be, I guess, a summation of what everyone has already said. I think there are many factors, the drought, of course, hasn't helped us. I was in Missouri this past weekend, and they had water running over the Missouri River up there.

Mr. SKELTON. That's in my district.

Mr. MARTIN. I know that.

Mr. SKELTON. We would gladly share some with you.

Mr. MARTIN. Yes, sir, it would be wonderful. But, obviously, you know, the weather conditions hasn't been right. The Lord hasn't treated us well there.

The energy thing, we're going through an adjustment there, and, of course, some of the banks are preoccupied with certain things, and, so, we're going through this adjustment phase now.

As Mr. Reed and others mentioned, we have many programs and we try and strive to get these programs out and make them available to the small business community. We work very closely with

the banks and leverage our resources there, the certified development company is another extension of our efforts.

We also are working very closely with the chambers of commerce, as you gentlemen know. There's 249 chambers of commerce in the State of Texas. Abilene has a very progressive chamber. Mr. Wade Terrill is the director and he'll be here today. They have a small business committee, small business council, and in an effort to get information out because we had this information explosion, but, it comes to a certain choke point and then it doesn't seem to get on down to the stream. We're conscious of the fact we need to get the word out on these programs and help people.

Mr. STENHOLM. Thank you, Mr. Chairman.

Mr. SKELTON. Thank you. Mr. Vandergriff?

Mr. VANDERGRIFF. Yes, I would like to ask Mr. Martin and/or Mr. Phillips, if he would care to comment question relative to these development companies that have emerged.

In the past, I have heard complaints from small business people that even though they might get a favorable audience with SBA, they could not persuade their local banks to be interested as a lender, even with SBA guarantees. There might be a variety of reasons of why that is so.

Are you finding through this Certified Lenders Program a greater willingness on the part of the banks to participate? Is there some incentive to banks previously uninterested to become active and involved? Do you see any trend at all in this direction?

Mr. MARTIN. Yes, sir. Congressman Vandergriff, we do, from the standpoint as banks become more knowledgeable of the program and aware of it, it's a little departure from our regular 90-percent guarantee where the balance of the loan is guaranteed throughout the maturity and so forth.

This program provides the banks will put up 50 percent of the project cost. However, they receive a first mortgage on the total plant and facilities, and the fund of the money, as we mentioned earlier, is limited to land, buildings and equipment, no debt payment or working capital.

So, once the bankers can see that they are pretty well protected with a 50-percent investment in the project, and they have a first mortgage, they seem to go along.

As a matter of fact, out of 50 certified development companies we have approximately, there's about 5 bank groups that have them. Then, of course, it's a Job Creation Program. We didn't dwell on that too much, but if you have a community, the banks are, in fact, trying to create jobs like they are in Brownwood and Pecan Valley, the economic development group over there, and in the Commanche area and west of there, here in Abilene, of course, you have Big Country that's part of the cog—Big Country Development Corp.

So, I think, given some time, the banks understand this. We're talking about, you know, 15 to 25 years and that always chokes up a banker traditionally, I mean, you know, because of the nature of it. But, they can come out first and it's a little bit different than our regular program.

Mr. VANDERGRIFF. So, you are very much encouraged by the banks' response to this program?

Mr. MARTIN. Yes, yes, sir, I am.

Mr. REED. Congressman, did you have reference to the certified? We have a Certified Bank Program and we have a certified development company program, and I thought you were referring to the Certified Bank Program. Were you talking about our 503 or the certified development company program that we have referred to as a Flagship Program?

Mr. VANDERGRIFF. Yes, I was. However, you raised an interesting point in my mind. Could you speak to the other program?

Mr. REED. Well, I was just going to mention the fact, of course, we do have certified banks, banks that have agreed to accept a greater responsibility in processing of the loans, in which in our endeavor to maximize our leverage to maximize the involvement of the private sector, we have a program referred to as the Certified Bank Program.

The bank agrees to provide a deeper analysis, long-term analysis of the credit. They agree to service the loan more extensively, and in return, we try to provide the bank with what we refer to as a 3 day turnaround, an answer within 3 days.

Now, in that program, the banks that are utilizing it, it is a medium sized to smaller banks that are most interested in this, certainly gives them a marketing advantage. But, again, it's had some problems insofar as there is a great need among bank loan officers, and we have certified some banks which, in turn, have lost the people that we have trained within the banks, to provide us really with the kind of packaging and kind of credit analysis that we require.

We have lost those from those banks, and as a result, over a period of time, we have reached what we refer to as decertified some of the banks. We have eight banks in the 72 counties. We have 640 banks in the 72 counties that we service. I would say maybe 5, maybe 7 or 8 percent of those are involved in the Bank Holding Company Program, but the vast majority of them are still being independent. You can see with 640 banks that the program is not extensive, but the banks utilizing it certainly are eager to use it.

Mr. VANDERGRIFF. I see. All right. I thank you for that extended explanation.

You recall yesterday in our hearings, that there was discussion relative to the recommendation by the gentleman who represented SCORE that they could be of some assistance, if properly informed, in broadening small business awareness of the loan programs available through SBA. I suggested to Mr. Sanders that this might be worthy of some study. Of course, you gentlemen are on the front lines, so to speak. I'd be interested in your reaction as to whether this might be a useful tool.

Mr. REED. I would say that the training of our SCORE volunteers is, of course, as in any endeavor, an advantage. As you witnessed yesterday, by the presentation made by Mr. Gibson we have some excellent people in the SCORE Program, and we do try to provide them with training.

There has actually been some training for SCORE volunteers in international trade. Mr. Gibson happened to have missed that,

been unavailable at the time, but, nevertheless, we have tried to provide them with training in that area.

Our training in respect to credit has been more limited primarily because we try to have the SCORE people direct questions to us as they relate to specific training. We, in the past, and the past is certainly not to judge what we will do in the future, however, I think as time has gone along, the SCORE Program has improved, we have improved as far as our working relationships, our working program with SCORE, but we will try to train the SCORE people as much as we can to try to prepare them to handle all types of questions. As you can imagine, for instance, in the Dallas downtown office, maybe on a peak day we may do 10 indepth counseling sessions.

We have, in fact, spread out our counseling services, our SCORE people are now working in conjunction with many of the chambers, and, of course, all over the country. We have spread them out over the Metroplex so people won't have to come downtown into Dallas. Dallas, of course, is a chore for almost anyone.

Mr. VANDERGRIFF. All right, sir.

Mr. REED. I think we all stand in praise of the SCORE people.

Mr. VANDERGRIFF. Thank you very much, Mr. Darby, I participated in a Public Works Committee hearing in Houston following the latest scourge down there and, of course, you were there. Your agency—your office—certainly received high praise for the promptness with which you came to the aid of those people who suffered such a tremendous damage, and I was very proud of that fact. I will say that, from time to time, I hear from farmers in my district. I do have some considerable amount of farming in my district. It's not all as highly urbanized as one might suppose since I come from the Dallas/Fort Worth area. Nevertheless Government programs, Government departments, are slow to react. Some mention was made of this earlier.

I cannot cite you any specifics in this regard. I suppose I'm not even necessarily asking you a question. It's just that I want some reassurance that our farmers, our farm industry will be the beneficiary of the most prompt kind of response time that we can offer to them.

Mr. DARBY. Congressman, when we first got back into the farm business, we started very slowly, and then we had a freeze in the valleys, a freeze all over Texas, and the place that was impacted the most was down around the valley areas. We received out of that area something like 1,400 farm type loans, and it did take us awhile to get it kicked off and to get it running because we didn't have a staff on board at that time qualified to handle that volume, and you know, for this type program, you can't just walk out and hire loan officers off the street, you know, instantly.

If we were talking about home loans, it would be fairly simple. We can hire people real quickly and have them trained real quickly. But, it took us about 3 weeks to get a sufficient staff aboard and probably another 2 weeks to get them trained and really up to speed. So, we did have a delay there, I am certainly not going to deny that.

At this time, we established and have in our office, a farm loan division because we feel they are specialized and we have people

that work on nothing but those. We don't want them to be going back from farm to home and business and what have you.

So, they work with nothing but farming, and we have about 30 loan officers in that division, and I had occasion here very recently to have a personal friend, who is a banker down in the valley who wrote to me and said, "I'm concerned, we're not getting any money down here, and it's taking much longer than what you projected."

In the farm loans, there are several steps that go through and in the particular case that this gentleman cited, 158 days had passed from the date that we opened an office in the valley to the date that he got his loan approved.

We went back through and traced where did the time go. As it turned out, we had to follow under our control a total of maybe 32 percent of that time, 51 days before we received an application, and it was 31 days to get the verification from ASCS. We don't do the verifications on farms because our verifiers are not farm experts. So, ASCS does that verification. I don't want to have that interpreted as saying ASCS wasn't doing their job; they have to contact the people and sometimes it's not always easy to contact the farmer; he's out farming.

So, most of the time, we didn't have that problem. As it turned out, we had spent a total of 50 days with the problem, including the credit reports, the writing reports and everything else and considering the backlog that we had at the time, I would say that was reasonable.

At the present time, once we get a verification in from ASCS on an application, I would say the average turnaround time now would probably be more in the neighborhood of 40 to 45 days. I wish it could be 15.

Mr. VANDERGRIFF. Well, we all do. I know you have worked to make it just as short a time as possible.

Mr. DARBY. We'll do our best.

Mr. VANDERGRIFF. Thank you very much. Thank you, Mr. Chairman.

Mr. SKELTON. Thank you, Congressman Vandergriff. Recently, gentlemen, we had a very interesting hearing chaired by the chairman of the full committee, Parren Mitchell, up in Boston relating to veterans loan programs, and I'd like to ask a followup question of Mr. Phillips, if you are the right one to ask, on the progress of the veterans loan program and this region and of any successes or failures or problems that you might have had.

Mr. PHILLIPS. Thank you, Mr. Chairman. I would like to give you some statistics on region VI.

Mr. SKELTON. I want more than just statistics now.

Mr. PHILLIPS. Then, I will comment on each one of these and where we think we can improve more.

Mr. SKELTON. Please.

Mr. PHILLIPS. First of all, we did make 342 loans since the beginning of this fiscal year. Through March 31, there were $43,074,000 in veteran loans.

Now, breaking it out for Congressman Stenholm and for Congressman Vandergriff, the Dallas district showed right at $7 million, and the Lubbock district was $4,158,000. Total number of

loans made in the region is 342, 42 for the Dallas district, and 28 for the Lubbock district.

So, that is the statistics. The veterans program, as you know, the loan program is our regular program. We are just giving emphasis to the programs we now have in place. We are having veterans meetings similar to some of your old town hall meetings where they are coming together with us. We do have some underway right now within this region.

I think it's an awareness program. I see it very beneficial. We're having good attendance, and some of the questions you are asking about the loans, about the programs, about management assistance, it's not always loans, just the fact that they didn't know about it, and this is an opportunity for us to tell them and work with them.

So, I feel, Mr. Chairman, at this point, we have certainly a ways to go. I wouldn't want to say that we are there. We are meeting those challenges by working with the various veteran organizations, which there is more than one, as we all know, and hopefully we can continue through the rest of this year with that same pace.

Mr. SKELTON. Let me ask you a couple of questions. How long have you been on board the SBA?

Mr. PHILLIPS. Sir, 11 years.

Mr. SKELTON. So, you've had the opportunity to work under the various administrations and through different economic problem times and so on. Can you give me any conclusions as to the change in direction that you have received from your superiors in Washington through these years? I know it's difficult. It's a general question, but any change in the trends that you would like to reflect over your 11 years in SBA? Particularly tying it to Congresses, if you wish, or to administrations, if you wish, to the economic national conditions, if you wish, or all three.

Mr. PHILLIPS. Well, as you know, Mr. Chairman, we are a small agency. We do have some flexibility by being small. I think that's an advantage, rather than being huge and large.

We know most of the people within our own organization from Mr. Sanders on down to the program areas. So, our communication has been improved with time. Yet, today, we find there is one emphasis today in the private sector, which I feel is a very worthwhile effort right now because we are being able to leverage our resources, such as the certified lenders programs, such as the 503, and so forth.

That is an emphasis that's been certainly accelerated here, and I can say that in this region, that it's paying off in benefits, and hopefully we can continue that way.

Mr. SKELTON. What are your default rates in each of the categories? Can you give me that?

Mr. PHILLIPS. Well, let's see here. I will defer to Mr. Martin. He's the finance man.

Mr. SKELTON. In loans in trouble, there was recently an interesting article that was written in the Kansas City newspaper and it listed loans in trouble in the same category as those in default.

Mr. MARTIN. Well, sir, we have a portfolio in region VI of about 83,000 loans approximately. That's about the number we have. For about $1½ million; 73 percent or so are current with no difficulty;

73 percent. We have another approximately 2 percent that have deferments. We have a category of past due, 30 to 59 days, and that's when we start to worry about it.

Mr. SKELTON. What percentage is that?

Mr. MARTIN. About 4 percent, a little over 4 percent, sir. Then, delinquent, 60 days and over, is around 16 percent, 14,000 loans.

Mr. SKELTON. Sixteen percent?

Mr. MARTIN. Yes, 16.85. Actually, 17 percent.

Mr. SKELTON. Can you give me any ballpark approximation as to the size of these loans, or is it all sizes?

Mr. MARTIN. It's all sizes. I could tell you this, sir, that that represents about 10 percent of the dollars, that's about $295 million.

Mr. SKELTON. OK. So, 16 percent are in that category, but it's only 10 percent of the dollar amount.

Mr. MARTIN. Of the dollar amount. So, we have numbers and we have dollars. Then, we have almost 5 percent in liquidation for about 4,000 loans out of the 83,000 cases that we have outstanding.

Mr. SKELTON. Four percent?

Mr. MARTIN. Yes, sir.

Mr. SKELTON. What's the percent of the dollars on that?

Mr. MARTIN. That's about 10 percent also, sir.

Mr. STENHOLM. Will the chairman yield?

Mr. SKELTON. Yes.

Mr. STENHOLM. That was a question, Mr. O'Jibway, that I was asking you for your district. How do your numbers compare to the regional numbers?

Mr. O'JIBWAY. Yes, there is a published document that they are pulling those figures from, from the management information summaries that are computerized and those statistics are available.

Mr. STENHOLM. That is what I asked you to submit for the record for the Lubbock district, what Mr. Martin just read from.

Mr. MARTIN. Would you like it now, sir?

Mr. STENHOLM. Sure. In region VI, you have 83,000 loans. What would the loans total in Lubbock?

Mr. O'JIBWAY. I've got a little more current figure, 9,920. This is at the end of April.

Mr. STENHOLM. What percent are current?

Mr. O'JIBWAY. OK. Our currency rate overall is 95.86 percent.

Mr. STENHOLM. Wait a minute here. We were just given 73 percent current, 2 percent in default, 4 percent past due, 30 to 59 days, 16 percent, 60 days. I want to compare apples.

Mr. O'JIBWAY. OK. I was reading off of my notes here, rather than this; there will be some variables in here because our statistics are taken off of our own records and there is some lag time in between these figures and the computer printout [MIS].

Mr. STENHOLM. To save time, if you could just submit it for the record, that will be fine.

Mr. SKELTON. Would you do it within 7 days, please, Mr. O'Jibway?

Mr. O'JIBWAY. OK.

Mr. STENHOLM. What I want is the comparison of the same numbers we were given on region VI for the Lubbock district.

[The information requested above, as well as followup comments, follows:]

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

SEP 5 1984

Honorable Charles W. Stenholm
Longworth House Office Bldg.
House of Representatives
Washington, D.C. 20515

Dear Congressman Stenholm:

At a recent hearing held in Abilene, Texas you requested information on the foreclosure activity in 1983 in the Small Business Administration's Lubbock District and a comparison of those figures to the Region VI foreclosure rate. As of December 31, 1983, SBA had 218 farm loans in the process of liquidation in Lubbock. These loans represent a total outstanding balance of $24,695,000. In comparison, Region VI had 712 farm loans in liquidation process for a total outstanding balance of $72,051,000. The Lubbock District has approximately 1/3 of the liquidation experience for Region VI.

As you know, the Lubbock District has been stricken by droughts for the past number of years. This section comprises the largest farming and ranch area within Region VI and would be most adversely affected by drought conditions. SBA has been working closely with these individuals to help them during this difficult period of time.

Sincerely,

Janine Perrignon
Assistant Administrator for
Congressional & Legislative Affairs

U.S. SMALL BUSINESS ADMINISTRATION
REGION VI
8625 KING GEORGE DRIVE BLDG "C"
DALLAS, TEXAS 75235-3381

Exhibit # 1

OUTLINE OF FINANCING SOURCES AND
SMALL BUSINESS ADMINISTRATION PROGRAMS

I. SOURCES OF CAPITAL

A. INTERNAL FUNDS
B. TRADE CREDIT
C. EQUITY SOURCES
D. REGULATED LENDERS
E. INSURANCE COMPANIES
F. MORTGAGE BANKERS
G. FINANCE COMPANIES
H. FACTORING COMPANIES
I. SMALL BUSINESS INVESTMENT COMPANIES
J. SMALL BUSINESS ADMINISTRATION

II. SMALL BUSINESS ADMINISTRATION FINANCING SOURCES

A. REGULAR BUSINESS LOAN PROGRAM
B. REGULAR BUSINESS LOAN PROGRAM FOR ECONOMICALLY AND SOCIALLY DISADVANTAGED INDIVIDUALS AND FIRMS, WORLD WAR VETERANS, AND LOW INCOME AND HIGH UNEMPLOYMENT AREAS
C. HANDICAPPED ASSISTANCE LOAN PROGRAM
D. SEASONAL LINES OF CREDIT PROGRAM
E. EXPORT LINES OF CREDIT PROGRAM
F. CONTRACT LINES OF CREDIT PROGRAM
G. 503 LOAN PROGRAM
H. DISASTER LOAN PROGRAM
I. SMALL BUSINESS INVESTMENT COMPANY PROGRAM
J. SURETY BOND GUARANTEE PROGRAM

III. SBA SIZE STANDARDS

IV. OTHER SMALL BUSINESS ADMINISTRATION PROGRAMS

A. ADVOCACY
B. PROCUREMENT
C. MANAGEMENT ASSISTANCE
D. MINORITY SMALL BUSINESS/CAPITAL OWNERSHIP DEVELOPMENT
E. 8a BUSINESS DEVELOPMENT

OUTLINE OF FINANCING SOURCES AND SBA PROGRAMS

I. SOURCES OF CAPITAL -

A. Internal Funds - One of the basic sources of capital is internal funds--money obtained from retained earnings. Many businesses do not have enough financial data or do not plan sufficiently to consider this alternative.

B. Trade Credit - Another neglected source of capital is normal trade credit. Some alternatives in which a supplier can directly or indirectly provide capital to a business are through (1) credit terms of 30, 60, or 90 days which can defray immediate use of owners capital for term of supplier's credit, (2) supplier equipment lease with option to buy rather than sell, (3) supplier sale of equipment on a term loan, (4) acquisition of inventory on consignment (pay for items only when sold), (5) floor planning.

C. Equity Sources - Consider personal financial situation as a source of capital through possible use of real estate equity (second mortgage borrowing), life insurance cash value, friends or relatives, credit union, etc.

D. Regulated Lenders (Banks, S&Ls) - Principal types of bank loans to small business concerns are commercial loans, character loans, term loans, accounts receivable loans, warehouse receipt loans, and collateral loans.

Commercial Loans - Usually 30 to 90 days and self-liquidating.
Character Loans - Short term signature variety without pledged collateral.
Term Loans - Maturities ranging from one to ten years may be secured or unsecured. Some lenders may seek SBA guarantees on some term loans.
Accounts Receivable Loans - The notification method indicates the lender will notify the debtor and will attempt to collect the receivable for the borrower. The non-notification method indicates the borrower will collect the receivable and repay the lender.
Warehouse Receipt Loans - Warehouse receipt is given to lender as security for loan.
Collateral Loans - Loans that are made by lenders on the basis of real estate, life insurance policies, chattel mortgages and stocks and bonds.

E. Insurance companies - Usually look for places to invest policyholder's money. Normally interested in real estate and new construction. Require long term maturities.

F. Mortgage Bankers - Usually finance real estate and construction capital needs. A money finder who brings the money source and the business together.

G. Finance Companies - Deal mostly in secured loans (unlike consumer finance companies) - Interest costs are generally higher than bank loans. Often furnish capital on cases banks reject.

H. Factoring Companies - Differs from other sources in accounts receivable financing in that receivables are purchased without recourse. Some factoring companies (usually finance companies) assume risk of bad debt.

I. Small Business Investment Companies - Licensed and regulated by the SBA. In business to provide equity capital, long term debt capital, consultation and advisory service to small businesses. Minimum equity requirements to organize is $1 Million. SBA leverages three to one.

J. Small Business Administration - Mandated to aid, protect, and assist eligible small businesses through various loan programs, procurement activity, business development guidance and management assistance.

II. SBA FINANCING SOURCES -

A. Regular Business Loans -
Limitations - Administrative Direct, $150,000; Statutory Direct $350,000; Guaranty Participation up to 90%, $500,000.
Criteria - Funds not otherwise available, good character, repayment ability, reasonable equity, collateral.
Maturity - Up to 25 years.
Interest Rate - 12-5/8% direct loans (second quarter FY84). Guaranteed loans, N.Y. prime plus 2-1/4 under 7 years, N Y prime plus 2-3/4 over 7 years. Interest rate with lender negotiable.
Eligibility - Subject to size standards - Acceptable Business.

B. Regular Business Loans for Economically and Socially Disadvantaged, World War Veterans, Low Income or High Unemployment Areas -
Limitations - Same as regular business loans, liberal interpretations of acceptable credit ratios and loan maturity may apply.

C. Handicapped Assistance Loans - All factors same as regular business loans except eligibility. HAL-1 non-profit organizations- At least 75% of work is performed by handicapped individuals. HAL-2 profit businesses must be 100% owned by handicapped principals.

D. Seasonal Lines of Credit -
Limitations - $500,000 or 90% of Line, whichever is less.
Criteria - Any small business having a seasonal loan requirement. Must be in business at least 12 months.
Maturity - 12 months from date of first disbursement.
Eligibility - Same as regular business loans - funds restricted to seasonal capital needs.

E. Export Lines of Credit -
Limitations - Same as seasonal lines of credit
Criteria - Must be in operation at least 12 months.
Maturity - Cannot exceed 18 months.
Eligibility - Same as regular business loans - Proceeds used for labor and materials applicable to import or export.

F. Contract Lines of Credit - All factors generally same as seasonable lines of credit except proceeds limited to labor and materials under an assignable contract for specific products or services.

G. 503 Program -
Limitations - Long term fixed asset financing for eligible small businesses primarily in expansion stage. Development company certified by SBA comprised of minimum 25 active participants, borrows funds from SBA and lender for reallocation to small business. Maximum 40% SBA injection not to exceed $500,000 in project through 100% debenture guarantee to Federal Financing Bank, Washington, D. C. for each identifiable small business concern.
Criteria - Plant acquisition, construction, conversion, expansion, including acquisition of land and fixed machinery and equipment. Private sector lender furnishes first 50% cost of project in exchange for first mortgage. SBA furnishes 40% cost of project in exchange for second mortgage. Development company furnishes 10% cost of project in exchange for third mortgage. Reasonable interest rate of first mortgage lender required.
Eligibility - Net worth of SBC may not exceed $6 Million. Two year average income may not exceed $2 Million. Proceeds cannot be used for working capital or debt payment.

H. Disaster Loans -
Limitations - $500,000 direct on physical and/or economic injury. Physical disaster loans no size standard. If credit elsewhere, interest rate 8%. If no credit elsewhere, interest rate 4%. Physical business loan maturities cannot exceed 3 years if credit elsewhere.

I. Small Business Investment Companies - Covered in Section I(I) of this paper.

J. Surety Bond Guaranty Program -
Limitations - Bid, payment, performance bonds and contracts for construction, renovation, service, supply, and janitorial work not to exceed $1 Million. Bonds guaranteed by SBA, are issued by surety companies approved by the U. S. Treasury Department.
Eligibility - Contractors with three year average annual receipts not exceeding $3.5 Million.
Fees - Contractor pays SBA 1/2 of 1% of contract amount for guarantee. Surety pays SBA 20% of premium. Premium cannot exceed 1.5% of contract amount.

III. MAXIMUM SBA SIZE STANDARDS -

A. Manufacturing - may range from 500 to 1500 employees.
Wholesale - 500 employees.
Service - Annual receipts range from $3.5 to $14.5 Million.
Retail - Annual receipts range from $3.5 to $13.5 Million.
Construction - Annual receipts range from $7.0 to $17.0 Million.
Farm Operations - Annual receipts may not exceed $100,000.

IV. OTHER SBA PROGRAMS -

A. Advocacy - Advocacy represents the views and interests of small businesses before other Federal Agencies.

B. Procurement - Obtains a fair proportion of Government contracts and subcontracts for small business. Awards Certificates of Competency when doubts exists as to whether a small low bidder has capacity to perform a Government contract. Also offers technology assistance to small business concerns in addition to a Procurement Automated Source System.

C. Management Assistance - Provides counseling and training services through SBA Management Assistance Officers, Services Corp of Retired Executives (SCORE) and Active Corp of Executives (ACE), To assist small businesses in development of objectives for successful organization and operation. The Small Business Institute (SBI) Program, a three way coalition of collegiate schools of business, the small business community, and the Small Business Administration, also provides counseling to the small business community through a university sponsored team of undergraduate or graduate students.

D. Minority Small Business/Capital Ownership Development - Helps promote and facilitate equal access in the free enterprise for socially and economically disadvantaged individuals and small disadvantaged firms through capital ownership and development. Capital structure assistance is provided by SBA business development specialists.

E. 8a Business Development - Offers Government contracts to socially and economically disadvantaged firms on a non-competitive basis to hire unemployed and underemployed individuals.

For further information contact SBA District Offices at these locations.

Albuquerque - 5000 Marble, NE, Suite 320, 87110	(505)766-3075
Corpus Christi - 3105 Leopard St., 78408	(512)888-3301
Dallas - 1100 Commerce, 75242	(214)767-0600
El Paso - 300 Pershing West Building, 4100 Rio Bravo, 79902	(915)541-7676
Harlingen - 222 E. Van Buren, Suite 500, 78550	(512)423-8934
Houston - 2525 Murworth Street, Suite 112, 77054	(713)660-4409
Little Rock - 320 Capitol Avenue, Room 601, 72201	(501)378-5277
Lubbock - 1611 10th Street, Suite 200, 79401	(806)743-7462
New Orleans - 1661 Canal Street, 2nd Floor, 70113	(504)589-2744
Okla. City - 200 N.W. 5th St., Suite 670, 73102	(405)231-5237
San Antonio - 727 E.Durango, Room A-513, Federal Bldg., 78206	(512)229-6105

U.S. SMALL BUSINESS ADMINISTRATION
WASHINGTON, D.C. 20416

AUG 13 1984

Honorable Ike Skelton
Chairman, Subcommittee on Export Opportunities
and Special Small Business Problems
Committee on Small Business
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

Enclosed are the responses of the Small Business Administration personnel who participated in the hearing in Abilene, Texas on July 11, 1984. As you will note, their views are candid expressions of their experience with the different programs as they have worked with them in the field.

In response to your question as to how the committee might help the Agency, several issues were raised. The following is a list of those suggestions and the Administration's position on these topics:

- Increasing guarantee limits to $750,000 - the Agency has limited resources to provide to the small business community and keeping the funding at $500,000 per borrower permits the SBA to help more small businesses.

- Direct loans - these loans are few in number, but take a great deal of time to process and service. They are loans of last resort and have a high default rate and are not an efficient use of the limited funds we have available. The small business community does not want them because small business owners feel that they are being awarded to businesses who cannot reasonably be expected to succeed. In addition, they contribute significantly to increasing the already staggering Federal deficit.

- Farm lending - the Agency does not have the resources or expertise to provide the assistance that the Department of Agriculture is able to give farm businesses. The agribusinesses can best be served through the efforts of FmHA. The existence of duplicative programs at both SBA and FmHA has caused many problems in the past. This duplication is a concern to both the Congress and the Executive Branch resulting in a drain on our resources and personnel.

The SBA will continue to provide capital to new and small businesses. There are many effective financing plans that make money available for projects that will continue to assist community development and business expansion. We shall continue to provide successful and productive programs to give small businesses and the Federal Government a strong return on their dollars.

Sincerely,

Janine Perrignon
Assistant Administrator, Office of
Congressional and Legislative Affairs

U.S. SMALL BUSINESS ADMINISTRATION
REGION VI
8625 KING GEORGE DRIVE BLDG "C"
DALLAS, TEXAS 75235-3391

July 16, 1984

Honorable Ike Skelton, Chairman
Subcommittee on Export Opportunities
and Special Small Business Problems
U. S. House of Representatives
1529 Longworth House Office Building
Washington, D. C. 20515

Dear Congressman Skelton:

During your hearings in Abilene, Texas, on July 11, 1984, you had requested that I submit to you in writing a response to the following questions.

1. We all know that some of SBA's program's are more risky (by policy) than others. Is there any program, however, that you see as particularly troublesome?

   A "troublesome" area within our 8(a) program is that of providing equipment to 8(a) contractors. In most cases, this has been done by utilizing business development expense funds. These funds have been made available to the contractor to purchase equipment that will allow him to be competitive in bidding against larger companies that have been in existence for longer periods of time. These companies have built up an inventory of equipment that, in many cases, is paid for and will allow the contractors the luxury of underbidding the 8(a) contractor. Needless to say, business development dollars can be very large in amounts. Many times, we do not have funds available to support this part of the program. To help alleviate this cost to the Federal Government, it would be well for Congress to consider amending legislation that will make available excess government equipment to the 8(a) contractor. The legislation should allow the Small Business Administration to take title to such equipment, then in turn lease the equipment to an 8(a) contractor pending his graduation from the 8(a) program. Upon his graduation, this equipment would be abandoned in place at no cost to the government allowing the contractor to keep the equipment and stay competitive.

2. Is there one program that is particularly useful?

   I would like to emphasize the importance of those programs that enable us to leverage our resources to assist small businesses, such as the Service Core of Retired Executives, Certified Development Companies, Small Business Development Centers, and Certified Lenders Program.

38-814 O—84——6

Questions from Congressman Charles Stenholm:

1. What is it that we (Congress) are doing that becomes a hinderance to you (SBA)?

   Legislation, that is made retroactive, has a negative impact upon the delivery of our programs, particularly in dealing with finance.

2. What is it that we (Congress) are not doing that we should be doing to assist your (SBA) programs?

   Conduct hearings in the field. SBA can benefit greatly when involved in congressional hearings held in the field. These hearings provide small business the opportunity to express itself and offer suggestions as to how our programs can be improved. By SBA's involvement in these hearings, we work closer with congressional staffs to help bring improvement.

G. Till Phillips
Deputy Regional Administrator

GTP:vld 7/16/84

SBA

U.S. Small Business Administration
Area III Disaster Office
2306 Oak Lane, Suite 110
Grand Prairie, TX 75051

FTS 729-7571
(214) 767-7571

P. 1 of 2

DATE: July 13, 1984

REPLY TO ATTN OF: George L. Darby
Area 3 Director

SUBJECT: Response to Congressman Charles Stenholm's Request

TO: J. Till Phillips, Deputy Regional Administrator
Region VI, Dallas

Question #1: "What are we doing in Congress that is a hindrance to SBA?"

Speaking only from an SBA Disaster Program point of view, the one type of action taken by Congress that causes us the most difficulty in the field is the passage of "retroactive legislation". It is further compounded when this is done and is tied to a specific date as opposed to disaster incidence periods. As an example of retroactive legislation in general, passage of P.L. 98-270 increased the loan limits on home and business loans retroactive to all loans approved on or after October 1, 1983.

Because of that legislation we had to notify all home owners and renters who had loans of $10,000.00 or more and all businesses that they might be eligible for larger loans. They then contact us and a very sizeable portion of our staff is tied up answering those inquiries. Those personnel could be processing loans for disaster victims as yet unserved. Because this was retroactive to a specific date of loan approval as opposed to a disaster incidence period, a great number of inequities result. Consider the position of a gentleman who lived on Galveston Island and whose home was destroyed by the hurricane. His real estate damages greatly exceeded our then-$50,000.00 limit. He was the ideal applicant. He came into the Disaster Assistance Center (DAC) fairly early and picked up his application. He diligently gathered all the correct information and returned his application in a timely manner. We verified his losses quickly (because he was early) and processed his loan quickly (because he was early). His loan for August damages was approved in September and therefore he is limited to the $50,000.00 amount. Some of his neighbors who procrastinated and didn't file until the October deadline are now eligible for as much as $100,000.00 to repair real estate damages. It isn't fair and it isn't equitable. Had the legislation been retroactive to "all disasters occurring on or after October 1, 1983" then all victims in Hurricane Alicia would have been treated equally While I feel all retroactive legislation presents problems, certainly a lot of problems can be avoided in disasters if the retroactive dates are tied to disaster incidence dates.

Question #3: "What are we not doing in Congress that is a hindrance to SBA?"

Suggestion #1: I would suggest when legislation is under consideration by the Congress that they submit copies of the proposed legislation, along with a statement as to what the intent is to be, to the appropriate Agency and specifically to that Agency's General Counsel for their interpretation of what effects said legislation would have on their Agency. This would make sure that the intent of Congress would be implemented by the Agency administering the new law. Several times in my experience with the Government I have seen examples of the Congress passing legislation designed to accomplish a specific goal, only to find that existing legislation prevents the new legislation from accomplishing its intended purpose. By way of example let me point once again to P.L. 98-270. A section of that law made small agricultural cooperatives eligible for assistance under SBA's 7b(2) economic injury disaster assistance program. I believe the obvious intent of this law was to make these co-ops eligible for the same assistance as their independently owned small business competitors. However, instead of classifying these small co-ops as "small businesses" for the purpose of 7(b)(2), the legislation actually created a new category for "small agricultural cooperatives"; therefore they fall under the SBA classification of "Other (non-profit organizations including charitable and religious organizations)". Therefore, instead of their interest rate being governed by the new section 7(c)(5), it is controlled by the unnumbered paragraph following the new section 7(b)(4). Because of this, any loans made to co-ops will be at 10½% whereas the same loan to a small business will be at 4%. Obviously this is not what Congressman Stenholm and other sponsors of the legislation intended; however, due to existing legislation that is the result. I do not believe that this is a case of our Agency attempting to thwart the will of Congress, but rather a case of where existing legislation contains certain requirements which have the effect of modifying new legislation. Perhaps this could have been avoided with prior-to-passage review and interpretation by SBA's General Counsel.

George L. Darby
Area 3 Director

U.S. SMALL BUSINESS ADMINISTRATION
Dallas District Office
1100 Commerce Street, Room 3C36
Dallas, Texas 75242

DATE: July 18, 1984

REPLY TO ATTN OF: DD - DAL DO

SUBJECT: Response to the Request of Congressman Charles Stenholm at the Abilene Hearing

TO: Deputy Regional Administrator Till Phillips - Region VI

As you will remember, Congressman Stenholm requested that I provide him with the benefit of my thoughts regarding two general questions: (1) What was the Congress doing in regard to small business that I felt they should discontinue; and (2) what would I like to see the Congress act upon.

The one action that I have seen the Congress take that concerns me a great deal is the passage of legislation that pertains to this Agency which seems to ignore our capabilities. The classic example might be the agriculture lending program, but of more immediate attention is the Small Business Computer Security and Educational Act of 1984. This measures allows the SBA to assist some companies in fighting computer crimes. The Agency is charged with establishing a program to provide information on the causes and nature of computer crime and offer training and education to deal with the problem. There is probably no Agency that is more poorly equipped to address this subject than the Small Business Administration. Our central computer system is and has been obsolete and undependable. We have yet to computerize our own activities and we have no one to my knowledge capable of assisting any small business with any of the multitude of small business computers and softwear packages.

As to the second question, I would like to see the Congress and the Small Business Committee more actively support the provision of resources and training to the Agency to enable it to handle the new responsibilities that the Congress endeavors to place upon us and in fact enable us to more efficiently accomplish our existing mission.

James S. Reed
District Director

JSR:DD:lv 214/767-0600

U. S. SMALL BUSINESS ADMINISTRATION
1611 10TH STREET, SUITE 200
LUBBOCK, TEXAS 79401
(806) 743-7462

July 16, 1984

Honorable Ike Skelton, Chairman
Subcommittee on Export Opportunities
and Special Small Business Problems
U. S. House of Representatives
1529 Longworth House Office Building
Washington, D. C. 20515

Re: Small Business Committee Congressional Field Hearing
Abilene, Texas - July 11, 1984

Dear Congressman Skelton:

The following information is submitted in response to the two questions directed to us at the above referenced hearing.

1. Outline those things which your committee could do to help our Agency as it relates to the West Texas counties in the Lubbock District.

Generally, the Congress has done a commendable job in mandating the programs of the U. S. Small Business Administration. However, we feel that we could do a better job if the guaranty limits were increased to at least $750,000 and do away totally with the direct loan program except in emergency situations such as major disasters, etc.

2. Outline those things which your committee may be doing or has done in the past that may be hindering the delivery of the Agency programs to the small business community in the Lubbock District.

Putting the U. S. Small Business Administration in the farm lending programs which are in competition with other federal agencies.

We certainly appreciated the opportunity to be a part of the Abilene hearing and, especially, to be permitted to present our comments and suggestions on how we can all serve the small businesses in West Texas in a more effective manner. Thank you for your continuing interest in this Agency and its programs.

Sincerely,

Philip J. O'Grady
District Director

PJO/mw

RESPONSE TO QUESTIONS BROUGHT OUT
IN THE CONGRESSMAN STENHOLM COMMITTEE HEARING
July 11, 1984, Abilene, TX

During the hearings before the Small Business Committee House of Representatives, Abilene, TX, July 11, 1984, a statement was requested to respond to the following questions:

1. What SBA program is considered to be troublesome or more risky (by policy) than others?

   Although it has been closed to new applicants, the Small Business Lending Company program has, among its dozen active participants, at least one troublesome and risky participant in this Region. Since these lenders are regulated solely by SBA, there have been control problems due to scarce personnel resources, both in the program area and in the Office of the Inspector General, which examines these lenders. Problem areas include inadequate capitalization, some violations of SBA rules and regulations, premature expansion, and other matters that have arisen which were not addressed in the regulations.

   The particular problems encountered since late 1983 in Texas with one of the SBLCs have been identified and are being resolved, due to the cooperation of its new management and ownership and the close coordination among our Lubbock and Dallas District Offices, the Dallas Regional Office, the Washington-based program personnel, and the Agency's Inspector General's staff. We are optimistic that the situation is improving. As the financial health of the Midland/Odessa area improves, we expect the SBLC to do the same. Clearly, SBA has learned from this one experience, in particular, that SBLCs can become quite troublesome unless we devote the necessary resources to prudently exercise our monitoring, examination and regulatory oversight authorities and responsibilities.

2. Is there one program that is particularly useful?

   A particular program considered to be very useful is the Surety Bond Guaranty Program that is designed to assist the small contractor in obtaining surety bonds to acquire commercial contracts not otherwise available.

   ~~The Agency mission to leverage resources through~~ The Development Company 503 Program and Certified Lending Program also are very useful SBA programs TO LEVERAGE RESOURCES TO THE PRIVATE SECTOR.

2

3. Is Congress doing anything that may be considered a hinderance to SBA effectiveness?

It would be helpful to consider SBA in the exclusive role of aid and assistance to the small business community and exclude lending responsibilities to farm businesses. In this respect, loan assistance to farm operations should be under the exclusive jurisdiction of the Farmers Home Administration. At the present time, the agencies overlap their respective program, i.e., SBA is in the farm lending business and the Farmers Home Administration makes loans to small and large businesses for purposes of working capital, acquisition of machinery and equipment and construction.

4. Is there anything that Congress should be doing to give more assistance to SBA?

The SBA needs the continued support of Congress to properly address ~~the needs~~ REASONABLE ASSURANCE OF REPAYMENT ABILITY of constituents concerning ~~the~~ declined loan requests.

J. F. BIMKINS
Acting ARA/P&I

	LUBBOCK DISTRICT OFFICE		DALLAS DISTRICT OFFICE		REGION VI		AGENCY WIDE	
	10/01/83	05/01/84	10/01/83	05/01/84	10/01/83	05/01/84	10/01/83/	05/01/84
DISASTER PORTFOLIO								
FARM ACCOUNTS	7,729	7,223	2,744	2,571	21,238	20,095	66,615	62,669
TROUBLE RATE	3.42	19.09	14.50	23.91	8.54	15.23	10.36	18.83
DOLLARS IN MILLIONS	374.5	336.0	122.9	113.3	1,105.0	1,006.2	2,591.7	2,338.3
TROUBLE RATE	7.01	16.40	20.37	27.76	12.65	20.73	15.63	
HOME ACCOUNTS	500	487	2,851	2,734	39,549	38,646	183,806	171,002
TROUBLE RATE	4.20	5.13	24.01	26.88	25.12	26.99	17.98	17.99
DOLLARS IN MILLIONS	5.5	5.1	40.3	39.1	227.6	226.1	977.8	934.9
TROUBLE RATE	3.74	4.73	15.76	17.17	21.11	22.14	14.89	
BUSINESS ACCOUNTS	386	420	508	489	7,239	7,208	44,850	42,896
TROUBLE RATE	4.91	9.99	16.33	26.17	12.39	15.46	14.26	16.32
DOLLARS IN MILLIONS	33.4	37.8	31.8	31.4	304.0	300.1	1,980.9	1,909.4
TROUBLE RATE	6.05	10.77	15.76	27.63	14.10	18.38	16.18	18.64
TOTAL DISASTER PORTFOLIO	8,615	8,130	6,103	5,794	68,026	65,949	295,271	276,587
TROUBLE RATE	3.53	10.95	19.09	25.50	18.59	22.14	15.70	17.93
DOLLARS IN MILLIONS	413.0	378.9	195.2	183.8	1,636.7	1,532.5	5,550.5	5,182.6
TROUBLE RATE	7.69	15.68	18.75	25.48	14.10	20.48	15.70	21.49
NON DISASTER PORTFOLIO	2,041	1,933	2,312	2,162	18,301	17,506	139,331	136,047
TROUBLE RATE	9.84	11.17	16.51	17.94	18.05	19.71	21.75	22.23
DOLLARS IN MILLIONS	146.5	145.1	197.2	188.8	1,341.6	1,300.2	10,601.1	10,572.6
TROUBLE RATE	9.93	12.15	18.59	18.77	19.38	20.72	23.19	23.15
TOTAL PORTFOLIO	10,656	10,063	8,415	7,956	86,327	83,455	434,602	412,634
TROUBLE RATE	4.74	10.99	18.39	23.44	18.47	21.64	17.64	19.35
DOLLARS IN MILLIONS	559.5	524.1	392.5	372.7	2,978.3	2,832.7	16,151.6	15,755.2
TROUBLE RATE	7.69	14.70	18.66	22.08	16.47	20.59	20.61	22.61

TROUBLE RATE: ACCOUNTS OVER 60 DAYS DELINQUENT AND IN LIQUIDATION.

Mr. SKELTON. Gentlemen, it seems that one question spawns another, and I'm afraid that we have run out of time. I do appreciate your being with us and your straightforwardness and the fine information you have brought with you.

Mr. Phillips, we will submit at least one question that I have, possibly more. If you would get them back to us, we will get them to you before you leave, and give them back to us within 7 days, we would appreciate that.

Mr. STENHOLM. Mr. Chairman, I would like to submit one other question. This is the same question I ended the panel yesterday on export/import banks, et cetera.

What I would like to know from each of you is the one thing that Congress is doing or has done that you wish we weren't doing, and the one thing that comes to your mind that we are not doing that you would like to see us consider doing in the 99th Congress to assist you in your work?

We'd like to have that from each of you for the record.

Mr. SKELTON. Thank you again very much. We will have a 5-minute break, no longer, and then hear from the next panel.

[A short recess was taken.]

Mr. SKELTON. This panel is known as the panel 3 on bankruptcy. If Mr. Stephens comes in, I would hope that you will escort him to the table, please.

Mr. Harris.

TESTIMONY OF CHARLES DICK HARRIS, ATTORNEY AT LAW

Mr. HARRIS. Yes, I am an attorney at law here in Abilene, practicing law primarily in the bankruptcy and insolvency area, and, I was asked to speak about the effect of bankruptcy on small businesses in the Abilene area.

I'm going to direct my comments to the broad area of bankruptcy, that is as it is widely defined by the public, which would involve companies that fail or go out of business, whether or not they actually file for bankruptcy.

In the Abilene area, there have been at least four major factors responsible for a number of bankruptcies. Primarily among these has been the decline in the oil industry. We have, over the last 2-3 years, suffered a tremendous decline in the oil business.

We were perhaps operating under a situation in which the oil industry was overinflated, or even maybe flying a little bit too high, so that when it started to go down, its effect was perhaps exaggerated. We've had our largest employer in Abilene and several other large statewide oil companies go bankrupt in the Abilene area.

We've had numerous other competing small businesses go bankrupt in the Abilene area, all of which can be related to this problem in the oil industry.

In addition, we had high interest rates for several years in and around here, which have had at least a dual effect. For both the company—they were having to pay this high interest and suffer through these hard times—was affected, and the customers were affected, the people couldn't get loans and then couldn't afford to make the payments on these loans, so they didn't buy. This hurt the companies, the small businesses in the Abilene area.

We've had a number of bank failures and takeovers by holding companies in this area. I think this has hurt, more so than probably a lot of people realize. When you're dealing with a banker that you've known for years, who understands your problems, who has been your neighbor, it's perhaps easier to explain your situation and get him to work with you than it is with an FDIC liquidator or some banker from Dallas or Houston who has been brought in by the holding company and who really doesn't care about your problems as much as he just wants to collect his loan as quickly as he can.

We've had a terrible last several years in the agriculture industry, out here. It's just been disastrous for almost all the farmers in the Abilene area and west of here. We haven't had any significant crops produced or sold in at least 4 years and this is going to be another bad one.

When farmers suffer, it hurts almost all the small businesses in the small towns, and it eventually is reflected in the larger businesses in the big towns. The general economic recession that has been going on through the entire country and the rest of the Nation has already suffered through, has finally hit out here in west Texas and I think it's reflected in the number of business failures and bankruptcies in this area. I think it's probably going to take a little longer for us to recover, because we were, on average, doing better than the rest of the country. Maybe we have further to fall and it hurt us worse.

I think if you're talking about bankruptcies in a strictly legal narrow sense as far as somebody who actually goes out and files for bankruptcy, that probably doesn't have that much monetary effect on other small businesses. I have found, in my practice at least, that most of those companies that file couldn't have paid or wouldn't have paid anyway if they owed somebody money.

They generally have already pledged all of their assets to some bank or financial institution, and there wouldn't have been anything there to collect from if you had the opportunity to file suit for the money and take a judgment.

So, from that point of view, if we're wondering whether the availability of bankruptcy protection is actually hurting small business I doubt that it is. It's in some cases perhaps even beneficial in the instances in which the companies can successfully reorganize under chapter 11. A small business creditor in an unsecured situation, which he always is, perhaps stands a lot better chance of getting paid than he would have had the bankruptcy not been filed, if the business simply closed up and a bank or savings and loan foreclosed and took back all of the assets.

So, in conclusion, at least as an attorney here in Abilene practicing in this area, I'd say that we have had more than our share perhaps of bankruptcies and business failures in this area, and they have had a severe, serious effect on small business in this community. I would have to blame our cause on just the general economic problems in the Nation, and the specific problem in the Abilene area, and not on any bad intentions on the part of the people going bankrupt or the bankruptcy laws themselves.

Thank you.

[Mr. Harris' prepared statement follows:]

Prepared Statement of Charles Dick Harris, Attorney at Law

The effects of bankruptcy or business failure upon small businesses in and around the Abilene, Texas area over the last three years has been enormous. At least ten major Abilene companies, including Abilene's largest employer other than the military, several of the state's largest independent oil companies, and three major automobile dealerships, have failed or filed for bankruptcy during this period of time. The reasons for this vary from case to case but are usually related to one or more of these factors:

1) The decline in the oil industry took many companies by surprise and those which were highly leveraged or unable to drastically reduce costs could not survive.

2) High interest rates for the past several years have recked the profits of already marginal companies and chilled the incentive of potential customers.

3) Bank failures or take-overs by holding companies have caused the long-time friendly banker of the small businessman to be replaced by an F.D.I.C. or holding company liquidator who does not understand, or care, about the needs or problems of the small businessman who finds himself, as a result of factors beyond his control, in a financial bind.

4) The general agricultural failure throughout West Texas for the last several years, continuing into this year, has been disasterous to almost all businesses in the smaller towns around Abilene and is beginning to be felt throughout the Abilene community as a whole.

The general economic recession which the rest of the country felt several years ago took longer to reach the Abilene area and will apparently take longer to leave.

When a small business has a customer which fails or files bankruptcy, the loss is twofold. Often, the customer owes the business money on account which is generally uncollectable as any

assets the failed business had are usually pledged to a bank or secured creditor so that nothing is left for the payment of general, unsecured creditors such as the small businessman. Additionally, there is the loss of a customer. In times like these, all customers are valuable and the lost future business can be worse than the uncollectable account.

This tends to be a vicious cycle which feeds upon itself. The bankruptcies of large companies bring on the bankruptcies of smaller companies, which bring on still other bankruptcies, which finally result in unemployment, personal bankruptcies, home foreclosures, and the sort of general economic depression which can cause the cycle to start all over again.

In a strictly legal, narrow sense, bankruptcies, the actual filing of a bankruptcy petition, whether Chapter 7, 11 or 13, have little real dollar effect on other businesses. This is because those persons or businesses who file usually could not have paid their accounts or survived anyway. The filing of a bankruptcy is usually preceded by a bank foreclosure or repossession, the execution or garnishment on a judgment, or some other catastrophic event which made continuing the business impossible. In some cases, the filing of a Chapter 11 petition for reorganization might actually be better for the small business which is a creditor of the bankrupt. The continued operation of the bankrupt business under the protection of the Bankruptcy Code may be the only hope the small business creditor has of ever getting paid.

In conclusion, small businesses are severely affected by the failures and bankruptcies of other businesses, some to the point of having to file their own bankruptcies, but the problem lies not in bad intentions on the part of the debtors or in the bankruptcy laws, but in the general, nationwide recession and the specific local problems faced in Abilene and West Texas.

Mr. SKELTON. Thank you, Mr. Harris. Mr. Wilcox?

TESTIMONY OF S.M. WILCOX, WILCOX & SONS

Mr. WILCOX. My main area of concern is with chapter 11 of the bankruptcy laws.

Mr. SKELTON. For the record, you are S.M. Wilcox, Wilcox & Sons, in Rule, TX.

Mr. WILCOX. Yes, sir. These chapter 11 laws, they hit us pretty hard. I'm a small businessman in Rule. We employ about 25 people, and this chapter 11 is hitting pretty hard.

We had one company that took chapter 11. They paid us some money 90 days, about 60 days before they took chapter 11, and 1 year and 11 months later, they were in the amount of $25,000. We got a letter from the bankruptcy court telling us to send the money back.

That's hard on the small businessmen, and they tell us we don't have any recourse but to send the money back. I have visited with—I have visited one bankruptcy attorney in Abilene, and he said he tells his people if the creditors get to working on it too hard, just go ahead and pay and we'll get it back anyway.

That sure does seem unfair for them to pay you a debt that they owe, they don't pay it all, and then in 2 years, you have to send the money back to them. Another attorney I visited said that he's handled several chapter 11's and he's never had one that reorganized and made a go of it. They always wind up in chapter 7, and we have never received a penny from anyone that took chapter 11, and I just feel like something should be done about this chapter 11 law to help the creditor of the people that take chapter 11.

Thank you.

Mr. SKELTON. Congressman Stenholm.

Mr. STENHOLM. Mr. Harris, you expressed your belief that we don't need to be making any changes in the bankruptcy laws. In your judgment, most of the problems are due to the state of the economy.

Mr. Wilcox, though, has a specific instance that I want to ask you to comment on, and that is in regard to the process of the filing of chapter 11. Mr. Wilcox's business paid a bill to a company 11 months ago.

Mr. WILCOX. Year and eleven months.

Mr. STENHOLM. A year and eleven months ago. How long prior to the bankruptcy was this paid?

Mr. WILCOX. Roughly 60 days.

Mr. STENHOLM. A 60-day period. Would you comment on the fairness and the adequacy of the law that allows an individual to come back on another business 60 days after the fact and collect on it?

Mr. HARRIS. Generally, I think what Mr. Wilcox is talking about is a preference problem. Some companies, prior to filing bankruptcy, will pay some creditors, say their friends and neighbors, people that they want to get paid, and not pay others, and then file bankruptcy.

The provision enacted with the last Bankruptcy Code, as it was with the Bankruptcy Act of 1896, set certain payments out as "preferences." Preferences could be set aside if it could be shown

that the person who received this payment would not have received as much money or more than his pro rate share I should say, if that money had instead been just simply paid into the general pool of all creditors.

There are a lot of defences to this. If you can show, first of all, that you were paid more than 90 days before filing the bankruptcy, if you can show that you continued to extend credit to the bankrupt after the payment and before they filed the bankruptcy, or that you provided additional consideration for the payment.

Generally, preference actions are undertaken by bankruptcy trustees after the filing of a chapter 7 or the conversion of the chapter 11 to chapter 7.

In my experience, I have never seen a debtor take chapter 11, try to work out his problems, and still go after his former creditors who were paid prior to the filing of the bankruptcy. I'm sure it happens in some cases, but it's a valid conflict of the laws and the interests of the different parties; the interest of all the creditors as a whole as opposed to creditors who received preferences. It's a balancing test, in my mind, as to which is the most superior interest.

I'm sure in some cases it gets to be unfair to people like Mr. Wilcox. Maybe this is something that ought to be looked into. Maybe we should shorten the preference period or add additional defences to it. But, on the whole, I would still have to stick with my original statement that few if any debtors are filing bankruptcies simply to get out of paying their unsecured debts. They are filing bankruptcies in chapter 11 to avoid foreclosures by banks, garnishment, and execution of judgment, things that are taking place that they feel are catastrophic to their businesses, that is going to put them out of business.

In Texas, at least, frankly, there is no way to collect on judgments because of our exemption laws in this State, and protections that are afforded to defendants in civil cases. So, I really feel like most creditors cannot really say they would have gotten any more money if somebody had not filed a bankruptcy.

The bank can't say that. A lot of times they are disadvantaged by the filing of a bankruptcy, but, again, it's a valid contest between the interest of the secured creditors and the unsecured creditors who are almost certain to not recover if the banks go through with the foreclosures and put them out of business and take all the assets.

Mr. STENHOLM. The public perception, from the political standpoint we deal with, is the opposite from what you have testified today.

Mr. HARRIS. I can't say that I've ever had a client come to me and say "I won't have to pay all these bills when I file bankruptcy." They come to me saying the bank is foreclosing tomorrow or they are out there picking up all my equipment and inventory today, what can I do about it, or maybe they are being sued by 15 or 20 different creditors and they can't afford to keep fighting them, one of those kinds of situations.

I don't really think, except for the rare exception, that a debtor files bankruptcy with malice toward their creditors, just trying to get out of paying what they know they owe. Most people that bankrupt are very reluctant about it and it is the last thing they want

to do. Frankly, they usually wait too long and that's why so few chapter 11's succeed.

Mr. STENHOLM. If I understand the preference laws you were referring to and the purpose of the law as it is now written, it is to avoid a situation in which certain people will pay to the disadvantage of others. The purpose of the law is to attempt to treat everyone as fairly as they can, given the unpleasantness of the circumstances.

Mr. HARRIS. Right.

Mr. STENHOLM. In the case of Mr. Wilcox, there was no preference made. He was receiving money from a company.

Mr. HARRIS. Apparently some other creditors didn't receive any money, and I would guess that they have complained to the bankruptcy trustee that Mr. Wilcox and other people got paid and they want something done about it. If the payments were made within 90 days, and they fit certain other criteria of the Bankruptcy Code, it can be set aside.

It doesn't happen often in my opinion.

Mr. STENHOLM. Do you have suggestions for this subcommittee of any improvements in the bankruptcy laws that would make it better?

Mr. HARRIS. Well, under the old Bankruptcy Act, an additional requirement was that you be able to show that the person receiving the payment knew or should have known that the company was insolvent, and that he was given a preference; whereas under the new code, this requirement was omitted. Now you simply have to show that the company was insolvent, whether or not the creditor knew about it.

With that in mind, it's much easier to prove it. Obviously, you don't have to show what the creditor knew. Whether or not this is worthwhile, I don't know. In some situations, it can be grossly unfair, where one or two creditors might have received all of the available assets of a company immediately before he files bankruptcy, and 100 other creditors out there didn't get a dime. So, you have to keep all this in mind.

Mr. STENHOLM. Mr. Wilcox, are there any comments that you would like to make?

Mr. WILCOX. Whenever we received this letter, we contacted these people and they told us we should have known that they were insolvent. How are you supposed to know that a company is insolvent? Did Mr. Harris say that had been changed?

Mr. HARRIS. Yes, I don't think that it's a requirement that you know.

Mr. STENHOLM. No further questions, Mr. Chairman.

Mr. SKELTON. Mr. Vandergriff?

Mr. VANDERGRIFF. Just a quick followup, please, Mr. Chairman, to Congressman Stenholm's last question to Mr. Wilcox. When you said you contacted them and they said we should have known, quote and unquote, I'm not sure I understand who they might be.

Mr. WILCOX. We received a letter from the attorney for the trustee, from NRG Resources, Robert P. Burnham and that's who we contacted. Mr. Burnham said you should have known they were insolvent.

Mr. VANDERGRIFF. I see. Well, I'd like to pursue the point that troubled me, where your situation is concerned. I don't mean to pry unduly, but this is a significant sum of money that you're talking about. Was it such that, and forgive me for not knowing more about your company, but was it such that it presented you with the kind of problem that you actually had to borrow some money in order to pay it back? Did it impede your operations in any other way? Meeting payroll, cash flow, whatever you'd care to tell us in that regard?

Mr. WILCOX. OK. We haven't returned the money yet.

Mr. VANDERGRIFF. Oh, you have not returned the money yet.

Mr. WILCOX. We contacted an attorney and we are going to take it as far as we can take it to see what we can do about not sending it back. There are four or five different people in this area that got the same thing, and we've all banded together and I don't think there is anything we can do about it, but we're going to see if we can.

Mr. VANDERGRIFF. Oh, I see. There are others then in exactly the same position as your firm.

Mr. WILCOX. Yes. If I have to send that money back, it will present a problem. It will present quite a problem.

Mr. VANDERGRIFF. Well, we needed to know that, of course.

Mr. Harris, first of all, I think you provide a very necessary service for your clients. I'm wondering if you are familiar with the recently enacted bankruptcy code reforms, one of the last actions we passed before this current district work period. If you are, what is your general reaction to those reforms?

Mr. HARRIS. Yes, sir. I'm familiar with it in that I've discussed it with Congressman Stenholm's assistant, Mr. Tobias. I have discussed it with our bankruptcy judge in Fort Worth.

I represent in my practice about as many creditors as I do debtors, so I kind of have to ride the fence as far as which way I lean on this subject.

I personally felt like it would expedite bankruptcies, the bankruptcy procedure, if the bankruptcy judges were giving article III status. I felt that that was a broader power with which to make decisions, to rule on cases, and just to get the thing over with.

Under the old act, and perhaps under the recently enacted legislation, I'm afraid there's going to be an awful lot of duplication of effort. They are going to try the case in bankruptcy court, then they are probably going to try it over again in the district court if it's of any importance.

However, I think it was crucial, and in importance it probably outweighed these other matters, just to get something passed. I'm very glad that we did, and I really feel like most of the bankruptcy bar worked well under the old system before we had a bankruptcy code, and we can continue to work under this one, but it will be different.

My understanding is that much of the related case jurisdiction has been moved from the bankruptcy judges. This is going to cause some problems for pending matters in which the bankrupt or debtor is suing other people to recover moneys that are owed to the estate or taking actions in regard to various contracts and obligations. These things which are not strictly bankruptcy matters are

going to be moved from the bankruptcy judges jurisdiction and probably have to be refiled elsewhere. The transition period may be somewhat difficult and unsettling, but, all in all, I think it will be all right. Again, I haven't seen the actual bill itself. I understand President Reagan hasn't signed it.

Mr. VANDERGRIFF. Well, that's correct. He has not signed it as yet. So, of course, it's not the law of the land. But Congress has acted, and, therefore, I was curious as to your reaction, especially as it might relate to the provision giving a judge the freedom to rule against one's ability to file Chapter 7.

Mr. HARRIS. I think there have been some abuses, certainly in larger cities. I have noticed in Houston and to some extent in Dallas, there have been so many filings that it's difficult for the courts to keep up with them. A lot of things are swept under the rug, the claims are not brought to the judge's attention, and he really doesn't have the authority or the power to do a lot about it, if it is, unless some creditor takes the time to show it to the judge. So, I feel like giving a judge some additional latitude to dismiss frivolous proceedings is not at all bad.

Mr. VANDERGRIFF. All right. Thank you very much. Thank you, Mr. Chairman.

Mr. SKELTON. I was going to ask you about the same bill. I appreciate Congressman Vandergriff bringing it up. If you're familiar with it, Mr. Harris, what about the provision dealing with bankruptcy of grain elevators? Can you give us an opinion on what we have done there?

Mr. HARRIS. Well, from the farmer's standpoint, it's fair and needed. Of course, there's a lot of other special interests out there that I think have equally been disadvantaged by the bankruptcy filings in the past.

I think we can maybe look at the situation of the working interest owner or royalty owner in an oil lease, who, when the oil purchaser goes bankrupt, as we had happen at least four times here in Abilene last year, and therefore, they don't get paid for the oil that was picked up. To me, that's a situation somewhat analogous to the farmer that places his grain in storage.

I'm sure there's hundreds of other examples of people who thought that they were more than just a creditor, and they come to find out after the bankruptcy is filed that they are still just an unsecured creditor.

Mr. SKELTON. Well, as you know, we had a very dramatic situation come to pass in Missouri. A young man was involved with this, and he ended up at the center of some litigation. Thereafter, it concerned many, many farmers very deeply. As you know, they took the grain elevator and they said it was not his anymore, and the thinking of Congress was this affected such a large segment of our economy, particularly in rural America, such as the district that I represent, we felt it was a step in the right direction, although it was not as strong as the piece of legislation we initially introduced.

Mr. HARRIS. Well, I don't think it's unfair. It's a situation where many people who sell goods that find themselves in that position. They think that they're going to get paid, that they have a right to take it back, and, unfortunately, under the uniform commercial

code that's enacted in 49 States, you're just an unsecured creditor unless you had the person that bought it sign a security agreement.

Mr. SKELTON. Any further questions? [No response.] Gentlemen, thank you so very much for being with us. We appreciate your time and your interest in our session. Thank you so much.

Mr. VANDERGRIFF. Mr. Chairman, could we request that Mr. Wilcox, perhaps through Congressman Stenholm's office, send us information as to the outcome of this matter? It does arouse my curiosity considerably.

Mr. SKELTON. Would you mind doing that, Mr. Wilcox?

Mr. WILCOX. Not at all. We have talked to Mr. Stenholm, and I told him we would keep him informed on this matter.

Mr. SKELTON. We would appreciate that, and, of course, Mr. Stenholm will notify the entire subcommittee.

Mr. WILCOX. We have received a 30-day extension on this. I don't know for sure when the time period is up. We received a 30-day extension to answer this request for return.

Mr. SKELTON. Thank you very much.

We find ourselves a bit ahead of schedule. Please be as simple in your usages of descriptions for this country boy from rural Missouri, if you don't mind. So, we'll recognize you first, Mr. Michel.

TESTIMONY OF GLEN MICHEL, EXECUTIVE VICE PRESIDENT, NATIONAL STRIPPER WELL ASSOCIATION

Mr. MICHEL. Thank you, Mr. Chairman. I want to apologize to you for my opening remarks in my statement. I addressed my own Congressman. I stand corrected.

Mr. SKELTON. He's the one you should address.

Mr. MICHEL. I'm very, very proud of Mr. Stenholm and his staff.

My name is Glen Michel. I represent the nation's stripper well operators. These are the people who operate the wells that produce less than 10 barrels per day. There are about 416,000 stripper wells nationwide. That comprises 71 percent of the nation's total wells, and those wells produce 2.92 barrels per day.

Mr. SKELTON. Excuse me. You mean on the average?

Mr. MICHEL. On an average, that's the daily average, 2.92 barrels.

They produce a significant quantity of oil, by the way, 442 million barrels approximately last year, and the yield to the producers is $12.8 billion, and to the royalty and landowners, $1.2 billion. A very infinitesimal amount, Mr. Chairman, in the western side of your state. Very, very small amount.

Mr. SKELTON. We wouldn't recognize it, if we saw it, right?

Mr. MICHEL. No, probably not.

In the national interest, you can see that if we replace each one of those barrels from overseas, we would have an additional deficit in the balance of payments of approximately $13 million each year. With that background in mind, I want to address two subjects before this committee.

One being the so-called transfer rule, which probably doesn't mean a thing to you. This is an area where a small independent producer chances to buy a producing property from a major oil company. At the time of the transfer, he is then saddled with a 60

percent windfall profit tax. As of today, the independent producer has none.

Mr. SKELTON. Excuse me for interrupting here. This is old stuff to these guys, but it's new to me.

Mr. MICHEL. All right. You have a well that produces less than 10 barrels a day, or you may have a lease and it may be 20 wells.

Mr. SKELTON. All right. Let's be real simple. One well.

Mr. MICHEL. All right.

Mr. SKELTON. Owned by a great big oil company, and the great big oil company sells this to Joe Doe, an individual, and this is what you call a stripper well, and your stripper well is exempt from the windfall profits tax, is that correct?

Mr. MICHEL. Not for the majors or not for those people who produce in excess of a thousand barrels a day.

Mr. SKELTON. But——

Mr. MICHEL. He is not a small producer anymore.

Mr. SKELTON. Well, let me go back. Joe Doe owns a stripper well. He has always owned it, for a dozen years he's owned it. He's not subject to the windfall profit?

Mr. MICHEL. No, sir.

Mr. SKELTON. Never has been, and he produces nine barrels a day and he's happy.

Mr. MICHEL. Right.

Mr. SKELTON. All right. So, a great big oil company sells him a second well that produces 9 barrels a day, less than the 10 barrel limit, and you're saying that this well that the great big oil company owned, they pay the windfall profits tax on that?

Mr. MICHEL. Right.

Mr. SKELTON. So, but, when Joe Doe buys it, what happens?

Mr. MICHEL. He would then be exempt from the windfall tax.

Mr. SKELTON. What happens to Joe Doe on this second well?

Mr. MICHEL. He would inherit that 60 percent windfall profit tax for the small producer.

Mr. SKELTON. OK. So, you're saying that this really, by all definitions, this is a stripper well, it's a small well, it's never going to produce more than 9 barrels a day forever, and when he buys it from a great big oil company, he falls in the same category taxwise as the great big oil company?

Mr. MICHEL. That's right.

Mr. SKELTON. Thank you.

Mr. MICHEL. Now, there is a good reason. What we are asking, Congressmen, is this. When the well is transferred to Joe Doe as you referred to, that windfall profits tax be eliminated for one reason, and that is to keep that well on stream for a longer period of time for the Nation.

Mr. SKELTON. Are you saying that the large oil companies would not?

Mr. MICHEL. They would not, they cannot under their giant corporate structure. We can reduce the cost of operating that well any place from 35 to 50 percent, which means that we can keep that well on stream and produce that well whereas if the major oil company kept it, could not sell it, they have to plug it. So, we lose those barrels to the Nation's economy then and there.

Mr. SKELTON. All right. Two questions. First question, what potential loss of oil production is there?

Mr. MICHEL. Of the Nation's total 50 percent, if you take all of the wells and do them that way. That's what the stripper well people produce, 50 percent.

Mr. SKELTON. So, you would keep that on line?

Mr. MICHEL. We would keep it on line.

Mr. SKELTON. Second question. What monies or income to the Treasury would be lost as a result of the windfall profits tax being paid off these stripper wells when they are sold to Joe Doe in this current story?

Mr. MICHEL. I can't give you an exact figure.

Mr. SKELTON. That's the first figure that the Ways and Means Committee is going to want.

Mr. MICHEL. I realize this, I realize this. On short notice, we did not have time to get it for you. I think we can get it for you.

Mr. SKELTON. Do you think you can do it within our 7 day? Do your best, do your best.

Mr. MICHEL. I will try.

Mr. SKELTON. At any rate, we would like to have that.

Mr. MICHEL. There is one benefit to the Treasury, though, Congressman, and that is this, by eliminating this transfer rule, when you transfer the 60 percent windfall profits tax, your major company would receive a higher price which he either must pay taxes on or he must drill it up in new exploration. One of the two things.

He's got to make some disposition of the capital he receives. I have given you an addendum to this testimony listing the pros and cons of eliminating the transfer rule on these stripper properties, which I have incorporated with this testimony.

Mr. SKELTON. Please proceed. Pardon me for interrupting.

Mr. MICHEL. That's fine. It helps me. I'm trying to catch where I am now.

I think the reason that we appreciate coming before the Small Business Committee is that this is probably the area where we need to start, and particularly since our own Congressman is on it, and since the Office of the Stripper Well Association is located in the 17th congressional district, that's probably the place we need to start.

Now, there is one additional item I want to bring to the committee and that is this, that's the rule of once a stripper always a stripper. That means another thing, Congressmen.

Under the DOE regulations, if we as producers have a lease with six wells on it, and those wells daily average is something less than 10 barrels a day, that means it would always be a stripper. No matter that we drilled a new well to the same horizon or to a different horizon. The IRS has changed that rule in mid-stream.

Mr. SKELTON. When did they change that?

Mr. MICHEL. January 1, 1984. We understand that there is a new order cut that has not yet been published. Counsel may have some recollection of this.

Well, anyway, what they did is they said this, on your lease it's once a stripper, always a stripper. If you drill a well to a new horizon, then that well was no longer a stripper well, no matter what the well makes, which is the——

Mr. SKELTON. On the same shaft, on the same hole?

Mr. MICHEL. A new well, Congressman. In other words, here is the lease. I've got 10 wells on that lease producing less than 10 barrels a day. They are all from the same horizon.

Mr. SKELTON. When you say horizon, you're talking about straight up?

Mr. MICHEL. Straight up.

Mr. SKELTON. OK.

Mr. MICHEL. Now, before we can drill an additional well on there, we moved it and made 50 barrels a day from this horizon, that well would still be a stripper well and came under the no windfall profits tax rule.

Mr. SKELTON. By regulation?

Mr. MICHEL. By regulation, administratively. They said if you drill a well to a new strata, that well now does not qualify as a stripper well on that property. We are hopeful that we can have someone check into this to see if the order has been cut, what they did with it, we don't know. We are operating in the dark. We don't know what to do. This has been going on for a period of 6 months.

I think Mr. Stenholm is familiar with this. In fact, I know he is.

Now, those are the only two things that I wish to bring before this committee, and when we're all through, I'd be happy to answer any questions.

I do appreciate your coming down to drought city so we can talk to you about these things.

[Mr. Michel's prepared statement with attachments follows:]

PREPARED STATEMENT OF GLEN MICHEL, EXECUTIVE VICE PRESIDENT, NATIONAL STRIPPER WELL ASSOCIATION

Congressman Stenholm and other members of the Subcommittee on Small Business, my name is Glen Michel and I appear here today in my capacity as Executive Vice President of the National Stripper Well Association. To refresh your memory, stripper wells—those wells that produce less than 10 barrels per day, make up 71% of the nation's total wells, which yielded an average per well of 2.9 barrels per day and are principally produced by small business people. The total production for 1982 from these wells was almost 442 million barrels of oil, which amounted to an estimated value to the operator of $12.8 billion and $1.6 billion to the royalty interest. While these may not seem like significant facts, let me assure you that every barrel we produce as stripper operators is one less barrel we purchase from overseas. We in effect deduct almost $13 billion off the balance of payments.

There are two items I wish to discuss before this committee. Number one being the so-called transfer rule, and if you are not familiar with this, this is the rule that forces stripper well operators to pay a 60% windfall tax on property they purchase from major oil companies or from those operators who produce in excess of 1,000 barrels per day. There are many logical reasons why the transfer rule needs to be changed or amended so that these wells might be kept on stream during the lower economic period of production. Stripper well operators are usually able to keep these wells on stream because they don't have the financial burden of a huge corporate structure and in most cases can operate the wells for 30–50% less than a corporation. I have listed on the attached sheet the various reasons why this rule should be amended and at the present time there is nationwide support among stripper well operators to have this rule amended and Congressman Stenholm, I hope you will help us along with your Small Business Sub-Committee in this effort.

The second item I wish to discuss is the change in the rule of "Once a stripper, always a stripper". In the past, when we had a 12 month production history of a property or lease where the average per well production was less than 10 (10) barrels per day, we could qualify this to the purchaser and it remained a stripper property for the duration of production, no matter whether we drilled additional wells which made in excess of 10 barrels per day or if it was drilled to the same producing horizon or a new producing horizon. On January 1, 1984, the Internal Revenue Serv-

ice determined that the "Once a stripper, always a stripper" rule was no longer valid and in the event we drilled a new producing well to a new horizon, those new wells would no longer qualify as stripper wells.

Gentlemen, these changes in the rules are constantly occurring and leave the producer not knowing from day to day how to conduct his business. We have information that leads us to believe that the I.R.S. is in the process of changing the rule back as it originally was, and we hope this is true, but it would benefit the stripper well operators nationwide very much if this Subcommittee on Small Business would check into this matter at the very earliest opportunity.

This concludes my remarks regarding these two areas of concern, but I would be most happy to answer any questions you might have concerning these issues. Thank you very much for letting me appear before this committee.

OUTLINE OF PROPOSED TAX REFORM RELATIVE TO PURCHASE OF STRIPPER WELL PROPERTY BY AN INDEPENDENT FROM A MAJOR

Outline of problem

Windfall Profits Tax applies to stripper well production owned by majors.

Windfall Profits Tax does not apply to stripper well production owned by independents.

If stripper well property is owned by a major it retains Windfall Profits tax characteristics when sold to an independent.

Proposed effect of legislation

Assuming a bona fide sale by a major to an independent, legislation would remove continuing applicability of Windfall Profits Tax to the production after sale. Thus, if the production is purchased by an independent from a major on a true arms length transaction the Windfall Profits Tax would no longer be applicable to the stripper production after it is acquired by the independent producer.

Benefits of such legislation

To The Nation: Rather than a major owned stripper well property being plugged and abandoned at the time it reaches the economic limit for the major where an independent cannot afford to purchase the stripper well production from the major because of the unfavorable economics of continuation of the Windfall Profits Tax, the production attributable to that property would be retained by the Nation. In addition reserves attributable to this remaining production would be available for production in the future thus enhancing the daily barrels of producible oil in the Nation.

Every barrel of oil which is lost by virtue of premature plugging and abandoning is a barrel of oil that must immediately be purchased from a foreign source. This would render less onerous the balance of payment problem attributable to the purchase of foreign oil.

Jobs attributable to continuation of production (both in the oil industry as well as all other related business which directly or indirectly depends upon the stripper well segment of the oil industry for employment) would be maintained. Obviously, the domino effect of plugging and thus resulting loss of jobs in all segments of the domestic economy would be partially reversed.

To the U.S. Treasury: Increased tax revenues would be garnered by the U.S. Treasury if elimination of premature abandonment of major company owned stripper well production could be alleviated. The major company would, in all probability, have a taxable transaction by virtue of the sale. In the event the major company was able to shelter this taxable transaction then the resultant tax savings would, at least in part, be reinvested by the major company in domestic exploration and development.

By virtue of an economic purchase of stripper production by an independent producer the resultant income either would be taxed or alternately if sheltered by virtue of intangible drilling expense the resultant production by virtue of the drilling incurred would be taxable.

Benefit To The Major Company Selling The Production: The major company selling stripper well production would have a more viable market and be able to attract a higher sales price by virtue of the property having a higher value due to elimination of the Windfall Profits Tax on the stripper oil after transfer was made.

Benefit To The Independent Producer Purchasing The Property: The independent producer purchasing the stripper well property would have additional opportunities of purchasing property which can be economically operated by the independent but which can no longer be economically operated by a major company. A traditional

source of stripper well production has been purchased by independents from majors of stripper well property which has reached the economic limit for the major company but which still is economically viable for the independent due to the independent's lower operating expenses and better utilization and care of the production.

Expected opposition to such legislation

With the exception of OPEC nations (and other foreign producers) no logical opposition can be expected to appropriate congressional action to implement such legislation. Assuming that the principal of supply/demand relative to pricing prevails in a post legislative atmosphere and that the "willing buyer/willing seller" principal of pricing is applicable there can be no logical opposition by any domestic entity to such proposed legislative reform.

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WILLIAM D. BARRY
Olean, N.Y.

JAMES BAKER
Bakersfield, Cal.

ARCH W. DEUEL
Casper, Wyo.

ELDON J. HAUGHT
Smithville, W.Va.

R. HARLAN KRUMME
Bristow, Okla.

JOSEPH K. McMAHON
Wichita Falls, Tx.

RICHARD L. RAY
Tyler, Tx.

BERMAN J. SHAFER
Wooster, Oh.

PAUL SIMPSON
Sedan, Kans.

RICHARD H. VICKERS
Smackover, Ark.

GEORGE H. WARREN, JR.
Owensboro, Ky.

EX OFFICIO
RICHARD L. VOCKEL
Newark, Ohio

OFFICE OF THE PRESIDENT
G.E. (Skip) STAHL
P.O. Box 2231
Amarillo, Tx. 79105

June 26, 1984

The Honorable Charles Stenholm
1232 Longworth House Office Building
Washington, D.C. 20515

My dear Congressman:

Your letter of June 21st announcing your small business sub-committee hearing in Abilene was most welcome. I have two issues which I would like to present to you and your visiting congressmen. The first being the transfer rule as it relates to stripper well properties. As you may or may not know, if we as small independents purchase a stripper property from a major oil company or from another operator who produces in excess of 1,000 barrels a day, we of course loose our depletion, but also we must continue to pay the 60% Windfall Profits Tax that is assessed the major oil companies. Stripper well operators are exempt from Windfall Profits Tax and it seems very logical that we need to change or at least amend this transfer rule. In my comments before your committee on July 11, 1984, I shall attempt to give you all the logical reasons why this rule should be changed.

The next item I would like to discuss is the "once a stripper property, always a stripper property" rule. On January 1, 1984, this rule was administratively changed by the IRS and at the present time stripper well operators or anyone who has a stripper property is in complete limbo. In the past, when a property was declared a stripper, it remained so even though we drilled a well to a different producing horizon on the same lease. This is the rule the IRS changed and has not as yet clarified.

There may be additional things that need to be brought before your committee, and if so, I will make very limited remarks in that regard. We are not naive enough to believe that we can pass or change much in this election year Congress, but we do hope to start the education process in the Congress to let them know what they are doing to that segment of the independents who can be classified as small business operators.

By copy of this letter, I am notifying Elaine Talley at your Abilene office of my desire to appear and am also notifying John Haugon of the two items that I am presenting.

Kindest personal regards,

Glen Michel/mle

Glen Michel
Executive Vice President
National Stripper Well Association

GM:mle

COPY

NATIONAL STRIPPER WELL ASSOCIATION
P.O. Box 3373 Phone: (915) 695-4966
Abilene, Texas 79604

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OFFICE OF THE PRESIDENT
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P.O. Box 2231
Amarillo, Tx. 79105

July 16, 1984

The Honorable Ike Skelton
Chairman, Small Business Committee
House of Representatives
1404 Longworth House Office Building
Washington, DC 20515

Dear Mr. Chairman:

As a follow-up to my testimony given to the sub-committee on small business in Abilene, Texas on July 11th, you asked for additional information regarding employment in the event the transfer rule for stripper oil well property was eliminated. My judgement is that there would be no material change in employment, probably less than 2,000 people one way or the other, because it requires a certain amount of personnel to operate an oil lease no matter who owns it.

You also asked for information regarding loss of revenue to the U.S. Treasury in the event this transfer rule were eliminated. First, Mr. Chairman, if the rule is not eliminated, there will be fewer property transfers, therefore no loss to the treasury, only an add-on to the imbalance of payments because we must purchase additional barrels of oil from foreign sources because of premature abandonment of producing properties that otherwise would have been kept on producing line. Secondly, there is probably no record of how many properties have already been transferred, nor how many properties will be transferred in the future because it is difficult to ascertain what the economic climate will be in the oil industry.

There is approximately a $3 per barrel tax on each barrel of stripper well crude oil produced by the major oil companies and those producers who produce in excess of 1,000 barrels per day. Also it is not known what percentage of the stripper wells are owned by the true independent producer and the major producers. If I had to make an assumption and we assumed that the majors

owned 50% of the producing stripper well properties and 10% of those properties were to be transferred to independent producers, and these properties were transferred over a period of 10 years, then a good guesstimate would be a $30 million loss of revenue over a ten year period or $3 million a year. Again, Mr. Chairman, there probably would be no loss to the treasury because any time a financial transaction is made, the company or person receiving the revenue must pay a proportionate value of the received price in taxes. And, if the transfer rule was eliminated, the purchase price again would be enhanced, making the property worth more, hence more tax dollars.

In closing, as I told you in the Abilene hearing, this is in the national interest because of the longevity of production; because stripper well producers who do not operate under a corporate structure with high overhead expense can keep our small wells on production much longer than those wells operated under a huge corporate structure. The gain from the longer producing life where wells are operated by small producers, in my judgement, more than offsets any loss to the Treasury in the long run.

I know I have not given you all the answers you require, but I would be most happy to sit down with your staff at their convenience in an attempt to come up with more substantial figures.

Thanks, Congressman, for your interest in the nation's problems and more particularly the small business entity of the oil industry.

Very truly yours,

Glen Michel

Glen Michel
Executive Vice President
National Stripper Well Association

GM:mle

cc: Charles Stenholm
Tom Vandergriff

Mr. SKELTON. I think Congressman Stenholm will tell you the action that he has taken in this regard, which he has just mentioned to me.

Mr. Taylor?

TESTIMONY OF RUSSELL N. TAYLOR, PRESIDENT, WEST CENTRAL TEXAS OIL AND GAS ASSOCIATION, ACCOMPANIED BY ALEX MILLS, EXECUTIVE VICE PRESIDENT

Mr. TAYLOR. Thank you, Mr. Chairman.

Members of the subcommittee, my name is Russell N. Taylor. I am president of Nordan Oil and Gas Corp., and its wholly owned subsidiary, Big Country Geophysical. My statement here today is presented on behalf of the West Central Texas Oil and Gas Association of which I, too, am president.

I would also like to comment on the fact that the West Central Texas Oil and Gas Association certainly endorses Mr. Michel's comments with reference to once a stripper, always a stripper, and his comments concerning the transfer rule.

WeCTOGA is a trade association based in Abilene. It is composed of approximately 1,000 members in the oil industry. Most of those are small, independent producers.

I come before you today not to seek any legislative changes from this distinguished subcommittee. To the contrary, I seek your support in preventing a harmful piece of legislation from becoming law. That bill is H.R. 4277, the Natural Gas Marketing Policy Act of 1984.

WeCTOGA believes that we have too much Government interference in the oil and gas industry today. We feel that the less Govdernment involvement, the better off everyone will be. Not only does that include the oil and gas industry, but also the general consuming public.

The Federal Government's involvement in the oil and natural gas industry during the past 11 years has grown by leaps and bounds. This involvement has created a flood of paperwork, confusion, and instability for the industry in general, and especially for the small, independent producer.

Since 1973, we have seen the U.S. Congress pass laws dealing with natural gas pricing and marketing, the crude oil windfall profit tax, an oil spill control measure, and the Clean Water Act. While on the surface this may appear to be minor involvement in the oil industry, in reality, the passage of the Natural Gas Policy Act and Crude Oil Windfall Profit Tax Act have had very detrimental effects in our industry.

First, both laws and subsequent regulations are very complex. They have created much confusion within the industry as it tries to separate the facts from the fiction. Both laws have created negative economics, and have been a major contributor to the cash flow problems many people in our industry are facing lately.

One example of the complexity and confusion created by the windfall profits tax can be illustrated by the fact that the Federal Government cannot agree on how it should define "property," one of the basic concepts of the law.

The Department of Energy has one definition, the Internal Revenue Service has another, and there are even two definitions in the act itself. The Internal Revenue Service recently has tried to modify the property concept as it deals with stripper wells, those that produce 10 barrels of oil or less per day.

The sole purpose of this proposed modification apparently is to raise additional tax dollars. Yes, it would initially raise a few additional tax dollars, but it also would create confusion within the industry, take valuable dollars away from these marginal wells and force the permanent abandonment of thousands of stripper wells.

The NGPA is no better. For example, there is absolutely no geological, engineering, or economic reason why one natural gas well should receive a lower price for the natural gas discovered if it is within 2.5 miles from a marker well than one that is 2.6 miles from a marker well, even if the concept of marker well is illogical.

Mr. SKELTON. Excuse me. What is a marker well, Mr. Taylor?

Mr. TAYLOR. This would be a producing well, a gas producing well, that is a controlled well whereby you have to move out 2½ miles from that well in any fashion and circle in order to achieve a different view, would establish a different price range.

By passing these laws and regulations that followed, Congress and various Federal agencies have placed a large paperwork and economic burden on the oil industry and especially on the small, independent producers.

Even though there may be nothing that this subcommittee can do to remedy this problem for the small producers, there is something that each of you can do immediately that will eliminate a future problem. This is to oppose H.R. 4277 that was recently reported out of the House Energy and Commerce Committee by the narrow vote of 22 to 20. I can tell you, as a matter of fact, that if H.R. 4277 becomes law, the paperwork and regulatory problems for small natural gas producers will increase even more. Producers would, for the first time, be subject to the FERC pipeline ratemaking process and new price arbitration mechanism. I thank you gentlemen for permitting me to submit this report.

[Mr. Taylor's prepared statement follows:]

PREPARED STATEMENT OF RUSSELL N. TAYLOR, PRESIDENT, WEST CENTRAL TEXAS OIL AND GAS ASSOCIATION

My name is Russell N. Taylor. I am President of Nordan Oil & Gas and its wholly-owned subsidiary Big Country Geophysical. My statement here today is presented on behalf of West Central Texas Oil & Gas Association of which I, too, am President.

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First, both laws and subsequent regulations are very complex. They have created much confusion within the industry as it tries to separate the fact from the fiction. And both laws are negative economics, and have been a major contributor to the cash-flow problems many people in our industry have been facing lately.

One example of the complexity and confusion created by the Windfall Tax can be illustrated by the fact that the Federal Government cannot agree on how it should define "property," one of the basic concepts of the law. The Department of Energy has one definition, the Internal Revenue Service has another, and there are even two different definitions in the Act itself. The IRS recently has tried to modify the property concept as it deals with stripper wells—those that produce 10 barrels of oil or less per day. The sole purpose of this proposed modification apparently is to raise additional tax dollars. Yes, it would initially raise a few additional tax dollars, but it also would create confusion within the industry, take valuable dollars away from these marginal wells, and force the premature abandonment of thousands of stripper wells.

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Thank you for the opportunity to appear hear today.

Mr. SKELTON. Mr. Mills, do you have something you'd like to add?

Mr. MILLS. No.

Mr. SKELTON. We appreciate your joining us very much. Congressman Stenholm?

Mr. STENHOLM. Mr. Chairman, I want the record to show that the chairman kept a straight face on once a stripper, always a stripper testimony, despite his lack of understanding of what we were really talking about.

Mr. Michel, I'm a little puzzled concerning January 1, 1984, changes that you mentioned were occurring, the letter that we sent, Congressman Vandergriff joined myself and 26 others in sending a letter to Mr. John Chapoton, Assistant Secretary of the Treasury on June 29, 1983.

Mr. MICHEL. It was January 1, of 1983, you're right.

Mr. HAUGEN. Are you talking about the proposed raise, January 20, 1983, wasn't it?

Mr. STENHOLM. On once a stripper, always a stripper?

Mr. HAUGEN. I thought you had said 1984 earlier.

Mr. STENHOLM. My information is we have not received any entry yet from the Treasury. We sent the letter June 29, 1983. We

were not aware of anything being done as yet and that's your problem.

Mr. MICHEL. That's our problem.

Mr. STENHOLM. OK.

Mr. MICHEL. We don't know where we are.

Mr. STENHOLM. You stated that something happened January 1, 1984.

Mr. MICHEL. Well, we understood, like you get the rumors on the Hill, that an order had been cut over in IRS that never has been published. It's just being held. We want to know where the order is, what it says, what can we do, are we going to be subject to paying windfall profits tax on that? What are we going to do? We don't know.

Mr. MILLS. Will it be retroactive, too?

Mr. MICHEL. Will it be retroactive?

Mr. MILLS. We have recently had a bad situation arise out of the Federal Energy Regulatory Commission. They have gone back and asked for reimbursement for overcharges on the way natural gas was computed. This came about through a court case and the clerk had to go back and they sought reimbursements, even though natural gas producers were in compliance with the order at that time.

They were now seeking reimbursements, and this is one of the concerns that we have concerning the IRS ruling. Are they going to go back and ask for reimbursements, even though we are complying with the law at the time, or the regulation at the time? That's our concern.

Mr. STENHOLM. Yes, and that jogs my memory of the Hightower-Stenholm statute of limitations bill. We've never been able to get action out of the appropriate committee on it yet. Producers should have some idea of what might happen to them 3 to 10 years in the future, and we're going to have to dust that one off and try it again through the committee.

But, OK, that answers my question. You haven't heard anything, we haven't heard anything, and we still want to hear from Treasury in regard to that ruling. We will follow up again with another letter.

Mr. MICHEL. The thing is, Congressman, are we going to go back 18 months and be forced to pay windfall profits tax on two or three wells we have drilled? It's like the guy with the bankruptcy laws, having to refund $25,000. Just like Alex was talking about, on your readjustment on Btu content, you're going to break some producers. They are going to be forced to pay $1 million, $1½ million, and they didn't know anything about this on this Btu adjustments. These are the kind of changes in orders that we don't know where we are from day to day.

Mr. STENHOLM. For the edification of our chairman, who I know to be very interested in the subject, even though he doesn't have quite the effect in his State we are talking about one-fifth of the available oil in the United States being in the stripper well category. The truth of the matter is whether it's a major or a small independent businessman producing that oil, no one can produce stripper wells with 60-percent windfall profits tax put on them.

Mr. MICHEL. You may in Pennsylvania, Congressman, where you have no State severance, you have no school taxes. In Texas, we

have all of that, plus we get by 62 cents out of every dollar. With the windfall, not on strippers, but with the windfall on a regular production, plus our severance pay tax, plus our school, our counties and the double digit not only on production, but also they get us on equipment values. They are not all the same, and I can tell you what it is in Texas.

Mr. STENHOLM. I thank you for correcting me. Every time I say no one or nothing or never, I always remind myself, you know, of the story of the dad that tells his son, you'll never own a motorcycle and he'll have one before the Sun sets that day, and you're looking at one. So, I thank you for correcting me, and when you say never, let me rephrase it.

You will see a tremendous amount of recapping of these smaller wells nationwide. Some percentage of them will be recapped because they are nonprofitable or unprofitable, and that's the problems. At some point, they get to be produced at a profit and I think that's the legitimate interest of the Small Business Subcommittee that I will be chairing very soon. I recognize this as a Ways and Means issue, but there must certainly be some joint jurisdiction. In fact, we would only get a small amount of jurisdiction, except for raising the issue and making it a part of these hearings.

Mr. MICHEL. Congressman, I don't think we're naive enough to believe any of us in the stripper well industry, as you know, we've got people scattered nationwide on our board, that we're going to run to Congress and pass anything after my 20 years on the Hill, back and forth. I know that you just don't run up there and do these things.

But, I do know this is in the national interests. In fact, it is so logical, it scares me because one of the things that is logical in Congress don't always get through the mill. But I think when you see the things that I have mentioned here, that you will recognize this is in the national interest.

I will give you one more thing to think about, Congressman. We are now plugging wells at a more rapid rate than we were, and I think this has some bearing on it. I'm not here to tell you that windfall profits tax alone will plug a well; it will not. It will at the very, very end, but right now, no.

But, our 5-year average on abandonment of wells is 7,868 wells. Last year, we plugged 9,426 in 1 year, and I think that will be way higher this coming year.

So, I think that these are facts we must look at in the national interests to keep these wells on stream because they are a significant factor, even though we are the poor boys in this segment of the industry. Most of them, a lot of them, are mom and pop operations, or a single man operator.

Mr. STENHOLM. Regarding the stripper well category, can you recite from the top of your head the number of jobs that we're talking about in this category?

Mr. MICHEL. I cannot, Congressman. I'm sorry.

Mr. STENHOLM. If you can, Mr. Mills, Mr. Taylor, add that to your testimony for the record within the 7-day period, I would appreciate having that number.

Thank you, Mr. Chairman.

Mr. SKELTON. Thank you. Congressman Vandergriff?

Mr. VANDERGRIFF. Mr. Chairman, I wholeheartedly endorse everything these gentlemen have said. I have no questions. All I have is support for what you're asking. It is in the national interest, I'm convinced of that now.

Mr. SKELTON. Gentlemen, I certainly appreciate your coming forward today. I got an education, particularly on stripper wells and your industry. I think this is something that truly your own Congressmen will pursue in the days ahead. You have at least saved one Missourian, and, hopefully, the rest of the subcommittee as a result of reading our testimony, we will at least have a working knowledge of what you're speaking about, and I understand the problem, I appreciate your taking the time to be with us today. That's why these hearings are so very, very important to us.

People who are not dealing with your particular problems can come down and hear them face to face. Thank you again for joining us.

We will adjourn for a short luncheon, and be back at 12:45 promptly and proceed then.

Thank you.

[A recess was taken.]

AFTERNOON SESSION

Mr. SKELTON. All three gentlemen are here. Please have a seat and proceed. We'll go from my left to right, 5 minutes each. Mr. Jarrell. State your name, your address and your occupation, please, sir.

TESTIMONY OF JOHN JARRELL, VICE PRESIDENT AND GENERAL MANAGER, EZELL-KEY GRAIN CO.

Mr. JARRELL. All right, sir. My name is John Jarrell, and I am the vice president and general manager and director of the Ezell-Key Grain Co. in Snyder, TX. We operate a country elevator and feedmill in this great county, and are concerned about the proposed regulations that are being proposed today.

Mr. SKELTON. Excuse me, Mr. Jarrell. Where are they now? I understand they have been proposed, but are we in the middle of the comment period or where are we, sir?

Mr. JARRELL. I understand, sir, that they are having hearings, three hearings over the United States, one of which is in Dallas plus or minus 2 days from today.

Mr. SKELTON. OSHA is?

Mr. JARRELL. OSHA is, yes, sir.

Our concern is that we would like for this committee to hear, would be how it has impacted on the small businesses.

Mr. SKELTON. Proceed.

Mr. JARRELL. We operate a small country elevator and feed manufacturing plant in Scurry County with approximate bushel capacity of 475,000 bushels of storage and a feed manufacturing facility that manufactures approximately 30,000 tons of feed a year. Both of which we put up in the classification of small operations.

The proposed OSHA regulations that would be affecting us directly would be a sizable capital expenditure, and the thing that concerns us primarily is the ongoing expenditure involving the

matter of housekeeping. The capital expenditures that we anticipate first year costs to our business would be some $70,175, and the housekeeping costs, about $188,269 annually. Primarily from the proposal that a facility must be swept every shift.

Mr. SKELTON. What does that mean?

Mr. JARRELL. They want a not less than one-eighth of an inch of grain dust on any platform area, work area, floors, ledges, basements, subbasements, any area of which is involved in grain handling facility. To accomplish this, they have offered, one, is an air handling system with no emissions, which, from our experience, is not a creature. Otherwise, it would require a housekeeping sweeping procedure, all platforms, all ledges, every shift, which would be, in our case, every 9 to 10 hours, working one shift would be once a day, working two shifts would be two a day.

We don't have questions to part of the proposals, some of which is involving capital expenditures on some devices that will be on grain elevator legs. I would say this, that we are concerned about the safety of our employees. We have an ongoing safety program. We have been in business since 1955. We have never incurred an explosion. We've never had an injury occur because of fire.

We do regret, when we read such in the paper or see it on the television, but small facilities, especially in west Texas where it's basically out in the country, don't have the same type of conditions to operate as a facility in a metropolitan area.

The proposal from OSHA would be all inclusive of all grain handling facilities. The feed industry, of which it is a grain handling facility, perhaps has one of the highest safety records of any part of the grain handlers.

The country elevators are right along with them, but the proposal is to be all inclusive and putting us in the same category as an export elevator over to the gulf, on the west coast, or an interior terminal elevator with facilities of 15 to 25 million bushels of storage capacity, and a high throughput.

The feed manufacturing industry, by its very nature, is slower handling of material, not all of which is grain. A lot of the material that we handle is not of an explosive nature. As a matter of fact, a lot of it is a retardant to explosion and fire. For example, limestone and clay materials.

There are also some inert type materials that we use, such as salt, dicalcium phosphate, monocalcium phosphate, which have a depressing effect. All of which are in the feed manufacturing ingredient usage, and we would like for the committee to consider, No. 1, that the proposals are trying to include everyone, of which perhaps not all of us belong, and, No. 2, that the feed manufacturing and country elevators should be given an exemption because of the extreme safety and good safety records that we enjoy.

The Texas Grain and Feed Association, of which I am a member and would like to speak on their behalf, if agreeable, proposes that all of the proposals be set aside until additional study can be made.

The OSHA appears to me to have wanted to get something on the books immediately, and they wanted to put everyone all-inclusive under one set of rules. The National Grain and Feed Association has spent some $3 million in pursuing the causes of explosions one item at a time. They did not come out with a shotgun ap-

proach. All of us in the industry are concerned about health and safety, not all of which is involved with fires or explosions, and we would like to have your consideration, please.

Mr. SKELTON. Thank you. Mr. Moore?

TESTIMONY OF ROBERT MOORE

Mr. MOORE. My name is Robert Moore. I live in Hamlin, TX. We run a country elevator, 1½ million bushels of upright storage, and we can do approximately 30,000 tons of feed at our feedplant.

Of course, we are also in the pet food business there, and we had on these regulations that we are looking at, we are looking at something very staggering in the cost. I know that costs might not come into effect on OSHA. Maybe their attitude toward that might not really affect them, but all factors are very heady, and I'll get into a few details.

You know, some of these standards that we were looking at, I work within 60 feet of our feedplant, and we have the rest of our family there all the time on safety business.

If we were going to have any kind of problems, we're there every day working, and we're going to be sure we're going to have something, with safety there to take care of us as well as all our employees. We're very concerned, but we also have an excellent safety record, and when we get down to the dust factors, we can have a little dust storm in west Texas that put more dust in the feedmill faster than we can even sweep it even if we tried to. So the climate conditions out here are a little bit different from what they would be back in the east coast area or whatever.

But on the cost factor, I know there was one thing that was a concern to a lot of our employees. As you unload grain, they have the grates where you have only a certain specific amount of room for the grain to go through, I'd say maybe we could get a few of the grains through the system, but like if you're unloading your meat scrapper or anything, you can't get it through the grate.

Mr. SKELTON. Say that again.

Mr. MOORE. OK. If you've got a grate, which goes up the elevator like what OSHA is specifying, you couldn't get anything through the thing. I mean, that's plumb ridiculous. You can't get a cotton seed through those, you can't argue it anyway and, you just have to change it.

We've got lots of grates and the cost we were looking at not a big cost, but we're looking at $7,800 just to change the grates and they won't work anyway.

So, then, John Jarrell was talking about housekeeping. I just got two bills figured in, not including our pet food plant, but our housekeeping bill on just the elevator is $36,000—what we call initial cost, $36,000. You might have some questions you might want to ask me, but we figured we went through the whole deal of what OSHA was trying to do. Our total costs on our two plants was $500,000.

Mr. SKELTON. What period of time?

Mr. MOORE. That's just trying to comply. That's just trying to comply. The first initial cost is $500,000. To a small business, that's just cutthroat, but to upkeep this on a yearly basis, just at our

feedplant, we're looking at $31,650 on one plant, and $73,700 on the other just on trying to keep everything going, and I'm afraid that a lot of this is not going to work in our situations out here.

Like I said, this is a family-owned business, and we're in a small west Texas town, and we're very concerned about our safety, but we're also concerned about the money that's going to have to run it. For a small business—not maybe for a big business—but for a small business, it's very high.

Mr. SKELTON. Thank you so much. Mr. George?

TESTIMONY OF THOMAS L. GEORGE, COORDINATING OFFICER, UNION EQUITY CO-OPERATIVE EXCHANGE

Mr. GEORGE. I'm the safety coordinator for Union Equity Co-Operative Exchange, with division headquarters in Enid, OK. My job includes the responsibility for the safety of 175 grain elevator employees at a 50-million-bushel plant in Enid, OK, 15-million bushel plant in Fort Worth, 8½-million-bushel export plant located on the Houston ship channel.

We never have had an employee killed by fire or grain dust explosion in the last 58 years of handling and merchandising grain, both inland and on the waterfront. In my opinion, the proposed rules for grain handling facilities are unnecessary, and to comply with them is cost prohibitive. The general duty regulations written by the Occupational Safety and Health Administration, Department of Labor, already cover the safety of employees in grain elevators. Why duplicate the regulations?

Union Equity Co-Operative Exchange has a safety program, and in opposing these rules, I'll specifically name out the four items that I have detailed in my talk.

First, with regard to housekeeping, which has already been mentioned here this afternoon, housekeeping as defined in the new proposed regulations for grain elevator facilities, are not necessary for Union Equity. In order to keep our elevators reasonably clean, a housekeeping inspection program is used.

The general manager receives reports every 30 to 60 days in writing from the compliance coordinating office. The elevator superintendent is directly responsible for housekeeping. He and his assistant make inspections every day to assign work at the beginning of each day.

It is just simply impossible to plan to sweep all the square feet in one of our elevators every shift. In our six terminal elevators, we have a 1,469,478 square feet, or in acres, that would be approximately 33.73 acres of ground or floor space to clean.

It is very difficult to tell someone in a rule how to complete this task. It is estimated the cost would be $2,929,024 per year to sweep one time per shift plus $880,800 for pneumatic cleaning equipment, or $3,809,824 the first year to comply. Proposed regulations require no dust emissions from pneumatic dust control systems. This is an impossible requirement. We have spent over $2½ million plus added operating costs for equipment to make our elevators safer and cleaner to work in.

One-eighth inch action level for fugitive dust is not desirable. No predetermined amount of accumulation of dust is acceptable to live

with. It will take both manual and pneumatic dust controls to keep the grain elevator reasonably clean.

The cost of complying with the inside bucket elevator legs for Union Equity would be $67,000. We have tried motion sensors that were too sensitive, which shut the leg off when it wasn't necessary. When we adjusted time delay, then it was too late. Bin eyes to control too much material entering the leg has proven effective for us. We also use the correct size heater coils for motor amperage to protect our legs from overloading. Static electricity has not proven to be a hazard in our bucket elevating legs. MSHA approved conductive grain belt has been installed. Leg motors are electrically grounded. We agree inspection ports on both head and boot sections are necessary, but to comply with OSHA is prohibitive.

Safety is very important in caring for bucket elevators. In fact, it is a hard and fast rule that our legs are manually inspected every 40 hours. Bearings are checked every shift. Belt alignment is checked every shift. Manual inspection of bearings and alignment are much more effective than sensors. Our operators have written instructions not to jog an elevating grain belt.

Next is emergency escape proposed rule requires two means of egress from scale floors. In most cases, this is a small area not over 40 feet square. Normally, only one man works here. He is provided with either a cage or belt lift with a ladder close by. A second means of egress would require an outside ladder which couldn't be very far from the inside ladder, and much more dangerous to climb than staying in the scale floor for help to arrive.

Most scale floors are designed with no flammable material. Therefore, I see no need for a second means of egress in the head house area. To meet these proposed rules would cost $20,893.

Grain elevators will experience problems if grates are reduced to 2½ inches by 2½ inch size requirements. On a number of commodities, someone would have to stand by and rake the grain and foreign material to let proper flow through the grate. Openings should be designed for the flow of material handled. Magnets are hard to design to handle 20,000 and 30,000 bushels per hour receiving belts, especially if the load is 6 to 7 inches deep. To put in overlay on our present grating would cost $10,602.

I have estimated that the initial cost in complying with the proposed rules would be $1,146,878, and the annual operating costs would increase by $3,699,074. This makes a total of almost $5 million, which would have to be passed on to the producer, who is already being taxed by low prices for his products. We have got to cut operating costs instead of increasing them.

In my observation, these rules should not be adopted as proposed, but a greater effort should be promoted to preventive maintenance. This would require emphasis on dust control, ignition sources, which in turn would reduce explosion hazards. Preventive maintenance would also improve efficiency with less unplanned down time, more efficient operation, and a safer operation.

It is the recommendation of Union Equity that National Grain and Feed Association be counseled and their expertise, gained from national research, be used to formulate any rules pertaining to grain elevator safety.

[Mr. George's prepared statement follows:]

Prepared Statement of Thomas L. George, Coordinating Officer, Union Equity Co-Operative Exchange

I am Loyal George, Safety Coordinator for Union Equity Co-Operative Exchange, with division headquarters in Enid, Oklahoma. This job includes responsibility for the safety of 175 grain elevator employees at a 50,000,000 bushels plant in Enid, Oklahoma, a 15,000,000 bushels plant in Ft. Worth, Texas and a 8,500,000 bushels export plant located on the Houston, Texas ship channel. I have been employed by Union Equity for 42 years. This included the construction of most of the storage in Enid, Oklahoma, 7 years as assistant superintendent, 16 years as elevator superintendent, then 15 years as safety compliance coordinator.

We have never had an employee killed by a fire or grain dust explosion in 58 years of handling and merchandising grain both inland and water front. In my opinion, the proposed rules for Grain Handling Facilities are unnecessary and to comply with them is cost prohibitive. The general duty regulations, written by Occupational Safety and Health Administration, Department of Labor, already covers the safety of employees in grain elevators, Why have duplicate regulations?

Union Equity Co-Operative Exchange has a safety program. This consists of one annual safety meeting held on company time with dinner included. All elevator employees are required to attend and a permanent record is kept of who did attend. All six elevator superintendents hold a monthly safety meeting at their individual elevators. Minutes of these meetings are kept on file. Different employees are assigned daily closing time walk through inspection, which is also in writing and kept on file. These inspections are discussed at the monthly safety meetings with all the employees. First Aid and CPR training sessions are held each year. Those attending receive a certificate which is good for three years, then it must be renewed.

Written instructions along with verbal training are furnished for all new employees whether permanent or temporary. Each employee must sign a statement that he has read these instructions before beginning work.

Hot Work within the elevator is discouraged, however, we do use Hot Work permits which must be signed by the individual elevator superintendent plus the maintenance superintendent. The plant must be completely shut down plus a complete clean up of the Hot Work area with the proper safety watch following completion of the work.

Bin entry permits are used; individual elevator superintendents must be notified and their signature on the permit before anyone is allowed to enter a bin.

All elevators have a written copy of Emergency Evacuation Procedures. This includes a diagram of each plant. Each new employee is instructed on what to do in case of an emergency, along with written instructions. All employees are instructed on Emergency alarm system. A copy of alarm signals are posted throughout the elevators for quick communications.

Union Equity has a no smoking rule within the elevator. No one smokes inside the elevator.

Outside contractors working inside our elevators are instructed in the same rules applying to our employees. The contractor is instructed to coordinate his work with elevator superintendent to insure that his men are safe and the elevator environment is also safe.

Housekeeping, as defined in the new proposed rules for grain elevator facilities, are not necessary for Union Equity. In order to keep our elevators reasonably clean, a housekeeping inspection program is used. The general manager receives a report every 30 to 60 days in writing from the compliance coordinating office. The elevator superintendent is directly responsible for housekeeping. He and his assistant make inspections every day to assign work at the beginning of each day. It is just simply impossible to plan to sweep all the square feet in one of our elevators every shift. In our six terminal elevators, we have 1,469,478 square feet or 33.73 acres to keep clean. It is very difficult to tell someone in a rule how to complete this task. It is estimated the cost would be $2,929,024 per year to sweep one time per shift, plus $880,800 for pneumatic cleaning equipment or $3,809,824 the first year to comply. Proposed regulations require no visible dust emission with pneumatic dust control systems. This is an impossible requirement. We have spent over $2,482,784 plus added operating cost of equipment to make our elevators safer and cleaner to work in. 1/8 inch action level for fugitive grain dust is not desirable. No predetermined amount of accumulation of dust is acceptable to live with. It will take both manual and pneumatic dust control to keep a grain elevator reasonably clean.

The cost to comply with Inside Bucket elevating legs would be $67,170. We have tried motion sensors that were too sensitive, which shut the leg off when it wasn't necessary. When we adjusted time delay then it was too late. Bin eyes to control too much material entering into the leg has proven effective for us. We also use the correct size heater coils for motor amperage to protect our legs from overloading. Static electricity has not proven to be a hazard in our bucket elevating legs. MSHA approved conductive grain belt has been installed. Leg motors are electrically grounded. We

agree inspection ports on both head and boot sections are necessary, but to comply with OSHA is prohibitive. Safety is very important in caring for bucket elevating legs. In fact, it is a hard and fast rule that our legs are manually inspected every 40 hours of operation. Bearings are checked each shift. Belt alignment is checked each shift. Manual inspection of bearings and alignment are much more effective than sensors. All operators have written instructions not to jog an elevating grain belt.

The emergency escape proposed rule requires two means of egress for scale floors. In most cases, this is a small area not over 40 feet square. Normally only one man works here. He is provided with either a cage or belt lift with a ladder close by. A second means of egress would require an outside ladder which couldn't be very far from the inside ladder and much more dangerous to climb than staying on the scale floor for help to arrive. Most scale floors are designed with no flamable material, therefore, I see no need for a second means of egress in the head house area. To meet these proposed rules would cost $20,893.

Grain elevators will experience problems if grates are reduced to 2 1/2 x 2 1/2 size requirements. On a number of commodities, someone would have to stand by and rake the grain and foreign material to let proper flow through the grate. Openings should be designed for the flow of material handled. Magnets are hard to design to handle 20,000 and 30,000 bushels per hour receiving belts, especially if the load is 6 to 7 inches deep. To put in overlay on our present grating would cost $10,602.

I have estimated that the initial cost in complying with the proposed rules would be $1,146,878 and the annual operating costs would increase by $3,699,074. This makes a total of $4,845,952, which would have to be passed on to the producer, who is already being taxed by low prices for his products. We have got to cut operating costs instead of increasing them.

In my observation, these rules should not be adopted as proposed, but a greater effort should be promoted to preventive maintenance. This would require emphasis on dust control, ignition sources, which in turn would reduce explosion hazards. Preventive maintenance would also improve efficiency with less unplanned down time, more efficient operation and a safer operation.

It is the recommendation of Union Equity that National Grain & Feed Association be counseled and their expertise, gained from national research, be used to formulate any rules pertaining to grain elevator safety.

Mr. SKELTON. Thank you, Mr. George.

Congressman Stenholm.

Mr. STENHOLM. Right now, I believe OSHA requires a one-eighth inch measurement for certain dust, housekeeping program, or a third option is pneumatic dust control mechanisms, and I gather from what you have said, none of those three requirments make a lot of economic sense.

Mr. JARRELL. That's right.

Mr. STENHOLM. You wouldn't choose one of them over the other. What you've all said is basically none of them make economic sense.

Mr. JARRELL. Right. If there was a type of pneumatic air handling system that would give us no visible sign of dust, which they are asking for, then that would be perhaps a way, but the creature doesn't exist.

Mr. STENHOLM. Say that again.

Mr. JARRELL. A pneumatic air handling system that would provide no visible dust, which means it would be 100 percent effective 100 percent of the time, they are asking for an impossibility, which leaves only the alternative of sweeping every shift.

Mr. STENHOLM. Is there any research available that you're aware of that indicates a relationship between thickness of dust and explosion of dust?

Mr. JARRELL. I'm not knowledgeable about that.

Mr. GEORGE. Well, I know that in the experiment that National Grain & Feed have made, they have actually exploded one-hundredths of an inch of dust in their test lab, so any amount of dust can be exploded.

Mr. SKELTON. I don't think it's the thickness on the floor, it's the composition of the air that is combusted. Is that not correct?

Mr. GEORGE. That's right.

Mr. STENHOLM. Well, that is the point that I was trying to make with the question here. There is no relationship to thickness, whether it's one-eighth or one-hundredth or one-tenth or one-thousandth. It really makes no difference. It's just the conditions present.

A fellow came by the office one day in Washington and was touting a system whereby vegetable oil was added, cotton seed oil, or soybean oil, in a spray. He was selling this as the greatest thing since sliced bread to take care of the explosive problems in the grain elevators.

Are you familiar with that process? Has it been looked at?

Mr. JARRELL. May I comment? I think that your firm has been involved in this some way, but the biggest problem that has shown up in the use of vegetable oil is the residity that prevails in the use of vegetable oil.

The thing they are working with now, which looks like a tremendous amount of potential, is mineral oil as a means of controlling dust or suppressing it. I won't say controlling it, but suppressing the dust. This is an outgrowth of the experimental work that the National Grain & Feed Association has been working very diligently on.

Mr. STENHOLM. I guess all of you would echo Mr. George's request that we encourage OSHA to look at the test results that are

now underway. As Mr. Moore stated, anyone that works in the grain elevator business with their family or otherwise, is just as interested in safety as anyone else.

There are research efforts being made right now to find ways to do a better job. You all are advocating that the proposed regulations not be implemented, but sit back and wait on a little more research before we spend a lot of money we may not have to spend.

Mr. JARRELL. We don't think that what's being proposed will be as beneficial as OSHA suggests by a long shot, not anywhere close, maybe 10 percent.

Mr. STENHOLM. Is there any difference between the feed mill operation and an elevator operation in what OSHA is recommending? Are they recommending the same thing for both the feed mill and the grain elevator? One and the same?

Mr. JARRELL. Yes.

Mr. STENHOLM. Is that acceptable? I mean, is it one and the same?

Mr. JARRELL. Yes.

Mr. STENHOLM. Is that acceptable? I mean, is it one and the same?

Mr. JARRELL. Yes.

Mr. MOORE. Yes. The way we figured up everything, every little bit of cost. I can give you the difference right here just on our elevator. It was a little bit cheaper. We're talking about $200,000 on our elevator where we're looking at about $373,000 on our feed mill.

Mr. STENHOLM. I wasn't talking about the cost. I was saying as far as the requirements on dust controls.

Mr. GEORGE. The same requirements.

Mr. STENHOLM. Same requirements on both.

Mr. GEORGE. All the regulations they have proposed provide for any grain handling facility.

Mr. SKELTON. What he's asking, is that a fair thing to do? Are you comparing apples and oranges? Is a feed operation different from an elevator operation?

Mr. STENHOLM. It is different?

Mr. JARRELL. An export elevator is different from an interior terminal, and an interior terminal is different from a country elevator, and a feed mill is different and a flour mill is different, and all of them are grain handlers.

Mr. STENHOLM. Is OSHA recognizing that in their regulations?

Mr. JARRELL. No, sir.

Mr. STENHOLM. They are requiring the same regulations on all aspects, even though they are different?

Mr. JARRELL. On grain handlers.

Mr. MOORE. You just take an export elevator; they are handling grain every day, and like in our elevator, we might go several days without handling any kind of grain. It makes a lot of difference how much you handle, I think.

Mr. STENHOLM. Thank you.

Mr. MOORE. So, every time you handle that grain, you're going to have dust. You have to be kind of real careful.

Mr. STENHOLM. No further questions.

Mr. SKELTON. Congressman Vandergriff.

Mr. VANDERGRIFF. Thank you, Mr. Chairman.

Mr. George, all of you gentlemen spoke very sincerely of how unreasonable these proposed requirements are. I certainly don't have any reason to challenge you in that regard, but you included something that was interesting to me here. Perhaps you've explained it and I wasn't expert enough to understand it.

You have made a statement of what you have just spent.

Mr. GEORGE. In the last 10 years.

Mr. VANDERGRIFF. In 10 years you have spent over $2 million in making your elevators safer and cleaner to work in.

Well, now, what they are saying is unreasonable, but evidently some other things were reasonable. Could you educate me a little bit as to what these specific things were that you did?

Mr. GEORGE. Well, the part that I complain about most is the housekeeping. We think we're keeping our house clean, but if we have to comply with these three different methods, it would put a greater burden on us. For instance, I'll illustrate it this way, if we have to sweep our elevators at least once per shift, would require us to have at least six sweepers. That's all they do, do nothing but sweep.

At the present time, we do not have anybody designated as a sweeper. That's why it would raise the cost that much more. That's our greatest concern.

Then, again, to these grates, we already have grates on our pits to protect the larger objects from going through, and making it available so the holes aren't large enough for a fellow to fall through it, but it protects him, he can walk over it, to let the grain or whatever material that's coming in, but if we abide by the rule of 2½- by 2½-inch square, it would restrict the flow of our grain.

We feel we have a safe operation right now, but we'd either have to add a grating over the top of the grate we already have, make that opening smaller and that would decrease the amount of raw material we could get through the grate, and that would run the expense up plus slow our elevator down.

Mr. VANDERGRIFF. Well, I can certainly understand what you're complaining about and fearing they might impose upon you. I suppose what I'm trying to do is to place myself in the position of arguing your case. I'm still not all that clear on what you have done in spending this sum of money to increase safety.

Mr. GEORGE. We have to comply with EPA regulations, which OSHA has nothing to do with EPA.

Mr. VANDERGRIFF. I see.

Mr. GEORGE. But, most of the——

Mr. STENHOLM. Mr. George, give us some examples of some specific things that you've done in your elevator, bought a fan, suction.

Mr. GEORGE. We have installed bag house filters, installing these bag house filters, we do not exhaust any dust out into the open, as we did previously in 1970.

We have never collected our dust and put it back in the grain, but a number of grain companies collect this dust and put it back in the grain.

If they abide by these rules to put in a pneumatic system to collect this dust, they are going to have to figure out a way to get rid

of that dust because they put it back in the grain. They are going to cause their elevators to be more dirty. That was the experience that we had by putting the dust back in the grain.

We keep the dust out and sell it as a byproduct is what we do, and that's where most of this money that I have said that we spent was for pneumatic cleaning system for our elevator to have a cleaner elevator and not contaminate the dust that goes out for the public to breathe or get on their clothes or on their paint jobs.

Mr. VANDERGRIFF. All right. Well, I appreciate that explanation. That helps a lot. Well, now, sweeping between every shift is totally unreasonable?

Mr. GEORGE. In our opinion, it is. We just couldn't comply with it financially.

Mr. VANDERGRIFF. But, now, you and the other gentlemen present, you must do some sweeping. What determines as to when you do that?

Mr. GEORGE. Well——

Mr. VANDERGRIFF. I may be asking what seems like an entirely layman's question, but that's what I am in this field.

Mr. GEORGE. We have it divided up that our elevator superintendent is completely in charge of keeping the elevator clean. Either he or his assistant is throughout the plant every day, and they determine what places need the most attention, and whether they are going to have to have someone do some extra sweeping during that day. That's our plan of keeping it clean.

We inspect it every day to know where our dirty spots are. You don't necessarily have to inspect it every day to know where it is, but we do look at it to know which one we are going to clean up first. Does that answer your question?

Mr. VANDERGRIFF. I think so.

Mr. GEORGE. It is a program that we watch all the time.

Mr. VANDERGRIFF. It's a matter of judgment on the part of the individual superintendent.

Mr. GEORGE. For someone to set out and make a rule on how we have to do that is pretty far fetched, I think.

Mr. VANDERGRIFF. All right. Thank you, sir, very much.

Mr. SKELTON. Ms. Pulley.

Ms. PULLEY. I just have one question. Apparently OSHA has been contracting out for the National Academy of Sciences and General Accounting Office to do special studies on how this would affect some small businesses and what needs to be done. Do you have any other recommendations on research that OSHA should be doing?

Mr. GEORGE. Well, as far as I'm concerned, National Grain and Feed is already in the process of making. They have several research products on the table right now that they are working on, and we need to at least let them finish those products. Maybe you can tell them how many are on the table right now.

Mr. JARRELL. There have been 20 that have been completed, and the findings published, and they still have an ongoing research program of which there will be in September, a sizable conference in New Orleans with additional findings from additional research.

Ms. PULLEY. I take it they are submitting those to OSHA and letting them be known?

Mr. JARRELL. They are making them available to everyone. It's public information.

Ms. PULLEY. OK.

Mr. STENHOLM. Mr. Chairman.

Mr. SKELTON. Yes?

Mr. STENHOLM. On that same line, have there been any studies which have looked into EPA's requirements to keep dust from moving out into the environment, and its relationship to grain explosions?

Mr. SKELTON. That is a very, very interesting question that your Congressman thought of. Think about it.

Mr. JARRELL. We have.

Mr. SKELTON. Answer it. Can you?

Mr. JARRELL. I can only speak personally. The problems that we've had have not really been a problem until we tried to handle without ventilation a highly combustible material, and to comply with EPA, have no discharge, no emissions, I think this is when the incident of occurrence really started happening.

Mr. STENHOLM. Were you aware of the study that has shown a relationship between certain EPA requirements and the level, or number of grain elevator explosions?

Mr. JARRELL. No, sir.

Mr. STENHOLM. Anyone? You seem to think there was such a study, but you have nothing to back that up?

Mr. JARRELL. We know that in areas where you can operate out in the country, where you don't have to live by these emission controls, and that have adequate ventilation, the feed mills, by their very nature, have, country elevators, by their very nature, have, have by far the safest safety record of any grain handling facility that's being included in the proposed rules.

Mr. GEORGE. I know in my first observation, when we first put our filters in, we attempted to introduce the grain back into the grain stream, and our galleries and bin top areas were immediately very much dirtier and we immediately quit doing that. We built dust bins and started putting the dust into dust bins.

Mr. MOORE. But, I would like to also say that when we're running grain over there in our grain elevator, when we're running those legs, that we like to have, you know, a window or two open because every time you shut—maybe a little bit of the dust is going to escape, but once you shut those windows, you get—I mean, where you're not having any kind of emissions, you're going to find—we have three hands over there, you're going to find three hands—you know, it's too dangerous. We've got to have just a little bit of emissions. I mean, from ventilation, not emissions, but ventilation, where you have a little bit of air coming in.

Mr. GEORGE. It's our common practice never to operate our elevator with the windows closed. We always open the windows. In fact, we think it's good for the grain to get that air going through it, especially even hot air is good for grain to get fresh air introduced into it.

Mr. SKELTON. Gentlemen, thank you very, very much.

At this point in the record, I would like to introduce without objection, the testimony of Hon. Virginia Smith, a Congresswoman from the State of Nebraska, who has submitted her testimony on

this issue and she would like for it to appear fully in the record immediately after these gentlemen's comments.

Mr. VANDERGRIFF. Mr. Chairman, could I inquire whether her statement—I take it you've read it. Does it tend to coincide with what these gentlemen have said?

Mr. SKELTON. I think so. I will quote very briefly from Virginia Smith's testimony. She is concerned.

> My chief concern, Mr. Chairman, in presenting this testimony, is the tremendous economic impact these proposed rules would have. One estimate puts the cost the industry in my State of Nebraska at over $31 million. This high cost, for rules that the Office of Management and Budget does not find productive, seems unnecessary and unwise.

So, I think what Congresswoman Virginia Smith of Nebraska is saying ties in very much with what these folks have testified to, and I will offer this to the reporter for its inclusion.

Thank you very much, gentlemen.

[Congresswoman Smith's prepared statement follows:]

Prepared Statement of Hon. Virginia Smith, a Representative in Congress From the State of Nebraska

Mr. Chairman and members of the committee, I certainly appreciate this opportunity to express my concerns about proposed rules regarding safety hazards in grain-handling facilities.

As a Representative from the state of Nebraska, I have special interests in these proposals. Nearly 800 facilities in my state would be affected.

I also have great concern for the safety of elevator employees and others in my district. Over 100 workers have died in the last 8 years in over 370 grain-handling facility explosions around the nation. Of all states, Nebraska has suffered the most, being the leading state in the number of explosion incidents. This year alone, there have been three explosions and two deaths in my state.

Clearly then, the need for greater safety awareness is present, and thus the motivating force for the proposed rules. I am, however, concerned about how increased safety is obtained. We must not adopt rules for the sake of having rules. They must be practical, feasible, and proven as to their effectiveness.

While many of the proposed regulations appear to be reasonable approaches to reducing the incidences of explosions and other accidents, others must be questioned as to their appropriateness. Housekeeping provisions in the proposed rules are perhaps the most

controversial. The one-eighth inch maximum dust accumulation level is an arbitrary figure and is not based on scientific evidence. This provision may result in increased costs without reducing the likelihood of dust explosions. Ironically, some facilities are prevented from lowering the risk of dust explosions, by government rules that prohibit the venting of grain dust during grain movement.

Another such case is the inclusion of mills is the same category as other grain-handling facilities which, from past experience, have higher risk of explosions. Many such mills in my district have expressed to me what they see as unfairness in being included in the same group as facilities with histories of greater frequency of grain dust explosions.

Efforts must also be made, Mr. Chairman, to avoid regulation duplication. Emergency escape provisions in the proposed rules are an example of this, as the Occupational Safety and Health Administration already regulates emergency escape from grain-handling facilities under its General Industry Standards.

It is also imperative that proposed rules be based on scientific evidence rather than on arbitrary standards. Inappropriate rules would be scorned by the industry, creating negative attitudes toward OSHA, and possibly inspiring scorn for other regulations that are necessary and even crucial for the safety of grain facility workers.

The proposed bin entry rules may be one such case. The rules have already been deemed inappropriate for some types of facilities by many

in the industry. Designation of which facilities should come under the new regulations should be made in cooperation with each different type of grain-handling business.

Another such case is the proposed 2.5 inch grate-opening size. Some feel the 2.5 inch opening size is an arbitrary figure not based on scientific evidence. The use of magnets is also questioned as to the technique's effectiveness and appropriateness for removing ferrous objects from the grain flow.

Perhaps the most effective measure proposed in the rules is the employee training program. I commend this recognition of the importance of employee training in the prevention of dust explosions and other safety hazards. I support increased training and further research on less costly means of hazard prevention; both are avenues for addressing this question.

My chief concern, Mr. Chairman, in presenting this testimony, is the tremendous economic impact these proposed rules would have. One estimate puts the cost to the industry in my state of Nebraska at over $31 million! This high cost, for rules that the Office of Management and Budget does not find productive, seems unnecessary and unwise.

Who will pay these tens of millions of dollars? Initially it will be the grain-handling facilities, many of which are small country elevators. There are hundreds of such small facilities in Nebraska's Third District. The tremendous cost of some of the proposed rules likely would put some facilities out of business. Just as disturbing

is the fact that these increased costs would eventually work their way back to the farmer in the form of lower grian prices. Grain-handling facilities can adjust their prices more easily than farmers who often must take what is offered for their commodities.

Again, I would like to express my thanks to the distinguished Chairman and members of the committee for the opportunity to present this testimony, and I commend you on your fine efforts on behalf of small businesses in the best interests of our country.

Mr. SKELTON. At this point, I promised a gentleman we would try to squeeze him in. We only have 2 minutes. If you take in 2 minutes, we'll let you do that.

I call now Mr. Jim Kelley on deck, as we say in baseball circles, the ball is here, you're next. So, why don't you come on up and state your name, address and your line of work.

TESTIMONY OF JIM KELLEY, PRESIDENT, CULTURED CATFISH, INC.

Mr. KELLEY. My name is Jim Kelley. I am president of Cultured Catfish, Inc., of Colorado City, TX. I am one of the few people that would admit I am in a fishy business.

I want to thank you, distinguished Congressmen, for allowing me to slip in here. I intended to put my name in the pot, but due to circumstances, I couldn't. So, I have a few comments I would like to make.

Congressman Stenholm said that he wanted to find out what you all are doing right and what you could do better. And, I have a few comments I'd like to make on that.

I want to commend Senator Bumpers and Congressman William Alexander for increasing the funding for the experimental station at Stuttgart, AR.

This is the first time since 1972 that they have had any substantial increase in funding, and we need it. Our balance of payments, I don't know where it stands now, but a few years back, fisheries imports was second only to petroleum. We're not doing much better right now.

In 1983, we had a 13-percent increase over 1982 in imports. Our exports decreased 5 percent in the same period. So, we are on a downhill run.

More for the domestic fish industry, in research and lack of stupid regulations would do wonders. We can't produce everything we import, but we can improve our production of edible fish products, with less regulations that make no sense.

Mr. SKELTON. What type of fish do you produce personally?

Mr. KELLEY. Killowatt catfish. I have produced red fish, which is a gulf fish, which this is a State problem. We can no longer do it. But, I have produced red fish, and they do three or four times

better than they do in the gulf. State problems, you all can't touch it. But, it's politics.

I can no longer get any fingerlings. I couldn't sell them if I had them.

Mr. SKELTON. What's a fingerling?

Mr. KELLEY. That is your small fish. When they hatch, they call them fry. They get a little bit bigger, they are fingerlings. When they get a little bit bigger, they are stockers. When they get a little bit bigger, they are keepers.

Mr. SKELTON. We understand.

Mr. KELLEY. There are a multitude of rules and regulations by EPA and various and sundry groups on being able to use the coastal areas for fish production. Some of those are completely unnecessary. Due to the fact EPA came out with a proposed regulation for fish hatcheries and farms 240-some odd pages thick, if that had gone through, I would have been out of business because I would have had to hire a full-time chemist to put in a lab to test for heavy metals, things that industry uses that fish farms don't even touch. In fact, the fish won't live in that type of water.

That is what I'm talking about. Useless regulations.

Mr. SKELTON. You have about 30 seconds more, sir.

Mr. KELLEY. Well, OK, I've got two more things I want to say on this OSHA. I've got bad news. Mr. Moore, I buy feed from him. If it goes through, my feed's going up. And, the windfall profits tax. The Government is confiscating my property without due process of law because I'm a mineral owner, I'm not a producer or anything else. That is a real asset they are taking away from me.

The producers have a chance to get their money back, the mineral owner has none.

I want to thank you for allowing me to get in here.

Mr. SKELTON. Thank you, Mr. Kelley. Your interest in coming today is appreciated very much.

Mr. STENHOLM. Mr. Chairman, I would say in regard to the catfish small business aspect that catfish farmers are, by and large, small business farmers. I look forward to working with you. Your association is both on the State and national level.

Mr. KELLEY. I appreciate it.

Mr. SKELTON. Thanks so much.

Ms. Geballe. Did I pronounce your name correctly?

Ms. GEBALLE. Yes, sir. Geballe.

Mr. SKELTON. We recognize you. State your name, your address and your occupation, please.

TESTIMONY OF LESLIE GEBALLE, COORDINATOR, GOVERNOR'S OFFICE OF ECONOMIC DEVELOPMENT

Ms. GEBALLE. My name is Leslie Geballe. I am employed by the Governor's Office of Economic Development and by Governor White in Austin, TX. I'm the coordinator for small business and I participate on the small business revitalization program.

Mr. SKELTON. Can you speak just a little louder, please?

Ms. GEBALLE. Is this working or not?

Mr. SKELTON. Pull it a little closer to you.

Ms. GEBALLE. OK.

[Pause.]

Ms. GEBALLE. I did bring some prepared testimony which you have before you.

Mr. SKELTON. We'll let that appear in the record as fully stated, and please summarize.

Ms. GEBALLE. Well, I would like to start with something else, and then go back to that, if I might.

Mr. SKELTON. Fine.

Ms. GEBALLE. I want to talk for a moment about the economic disaster loans that were proposed earlier this year to aid businesses hurt by currency devaluations in other countries. We have a significant area of Texas that has suffered from such circumstances and could make good use of disaster loan assistance.

When we first heard about this loan program, we were very, very pleased to hear that some assistance would be available. We, in the Governor's office, hear daily from the businesses along the border about the injury they have suffered and how difficult times are. We were less pleased when we found out that businesses hurt by currency devaluations were going to be competing with businesses that were hurt by the PIK Program, agricultural businesses for the same pot of $100 million.

A quick calculation told us that every State in the Union would probably have businesses that could claim injury due to the PIK Program, and that our border businesses would probably be left with very little of the $100 million, if any, after the agricultural community got its share.

Be that is it may, we haven't as yet received any regulations governing implementation of the Disaster Loan Program. There seems to be a delay in getting those regulations out. We have called Washington several times to try to find out what's happening and can't get any definite word. We are still waiting and we're eager to have this program to implement.

That's all I wanted to say on it.

I'd like to go to my prepared statement. Ten months ago, the Governor initiated the office of economic development to carry out his commitment to enhance economic development in the State of Texas. Since that time, our office of economic development has been exploring small business policies of test dissemination to determine how we can improve our climate for small businesses.

Six months ago, we joined the Small Business Revitalization Program, which is a federally sponsored program by HUD and SBA, and in the past year, we have talked with several hundred businesses, banks, not several hundred, but numerous banks and certified development companies around the State. In addition, we have experienced a gamut of Small Business Administration offices. Texas has six district offices and one regional office. The SBA services that we have had most contact with are the Management Assistance Program and the SBA Loan Program. Because SBA operates in a decentralized fashion, each office has complete discretion, within some guidelines, to approve or reject loan applications. All the offices have been very helpful in offering management assistance to clients we have sent.

Current financial conditions are a major factor in the ability of small businesses to thrive and to grow or expand their physical fa-

cilities. Availability and cost of money are two of the biggest problems small businesses face, and are in many cases the keys to survival.

Making sure that cash in is greater than cash out is tough, particularly at interest rates firmly established at 14 percent and now beginning to flirt with 15 percent. Small businesses generally can't grow without borrowed money, but at 14 to 15 percent, it's not clear that they can grow with borrowed money.

The SBA has two sizable loan and loan guarantee programs that we use frequently, the 503 program, which I gather you heard about earlier this morning, and the 7(a) program.

The 503 program, created to make long-term, fixed interest capital available to small businesses is a unique and successful lending tool. Congress, eager to encourage small business expansion, and, therefore, stimulate job creation, decided that long-term capital was the needed catalyst. It is a needed catalyst, but current high interest rates are negating the value of long-term money. Businesses are understandably hesitant to lock themselves into the 20- to 25-year loans at 14.5-percent interest rates. Some businesses are choosing conventional loans, floating at prime plus 2 in the hope that interest rates will drop. These loans are generally representing a 2-year commitment, renewable on the lending institution's option, could prove devastating in the long run, both in expense to the business and because they can be called instead of renewed.

The 7(a) loan guarantee program is designed to help businesses that cannot obtain a conventional loan because the loan represents more risk than a conventional lender is willing to assume. However, at high interest rates, prime plus 2¾ is the maximum, the 7(a) loan is available to profitable businesses that can afford the terms, and businesses that meet strict repayment ability and collateral criteria.

For businesses that really need help, 7(a) loans may be the only assistance available. But high interest rates and cautious loan officers are turning the 7(a) loans into a bonus for banks, rather than a salvation for small business.

We are aware that SBA has been criticized for losing money through loans that were never repaid. SBA offices have remedied this situation by tightening their lending criteria and acting quickly on foreclosure. Undoubtedly, the SBA has improved its portfolio performance. While we agree that taxpayers' money should not be wasted on bad loans or on applicants that are ill prepared to assume the responsibilities of operating a small business, we sense a need for the SBA to be the one agency that has the freedom to take calculated risks in its lending practices.

Our impression is that many SBA offices have become risk-averse to the point of appearing only to help businesses that do not need help. What we are dealing with is a question of intent. If Congress intends for SBA to secure the taxpayers' money in sound, low-risk loans, then we must accept that practice. However, if Congress intends SBA to help truly needy businesses through a crunch or through an expansion, then it must make that policy clear.

Since SBA offices differ significantly in their loan approval policies, suggestions that we offer will apply to some offices more than others.

We suggest that Congress and SBA consider approaching the loan approval decision with more emphasis on credit history, sound business plan and business track record in cases where collateral appears to be less than sufficient.

That SBA consider forming loan teams in their offices to allow more than one loan officer a voice in the decision on individual loan applications. Limiting the collateral on the SBA loans to the items covered by the loan, property owned by the business, and the required personal guarantee, rather than as some SBA offices are doing, demanding excess collateral on loans.

On the subject of interest rates, I would urge Congress and the SBA to seek every possible means to lower the interest rates on SBA loans, both 503 and 7(a). If H.R. 4773, a bill to improve the secondary market for guaranteed SBA loans will actually lower interest rates, let's make sure it becomes law. In closing, I would like to add a couple of words about management assistance. Many small business owners, particularly new ones, are surprisingly ignorant of management and financial practices which could improve their business performance.

The SBA has been a major provider of this type of assistance for many years. As SBA has cut back on this service through its own offices, it has set up the Small Business Development Center Program whereby individual States through universities are becoming the home for technical and management assistance for small businesses.

SBA matching funds to what the State or the university provides, as well as assistance in setting up the SBDC's and monitoring their performance.

In Texas, we have just begun this program. We have established two centers and we think we're going to like this system a lot.

We urge the continuation of the SBDC program at funding levels that allow it to be effective, and by next year, we ought to be able to comment on what those levels are.

Thank you for hearing my testimony.

Mr. SKELTON. Thank you very much, Ms. Geballe.

Mr. Stenholm.

Mr. STENHOLM. We on this subcommittee have recognized the same catch-22 that you have mentioned in your testimony regarding the purpose of SBA loans and just what congressional intent is in determining who is eligible for an SBA loan.

It's one of the most difficult aspects of the entire program. Who is going to make that determination? The potential for abuse is tremendous.

You mentioned the loan committee in the SBA offices. Have you or anyone you're aware of given any consideration to having private citizenry input from the standpoint of a loan committee or some type of a loan committee?

Ms. GEBALLE. In dealing with SBA?

Mr. STENHOLM. In dealing with SBA.

In Farmers Home, we have an accounting committee, and it isn't working as well as it should. We are working on that and the Farmers Home aspect.

With the loan guarantee program, I have felt along with most people that we have local input; with the local financial institution, you're getting that local input.

Ms. GEBALLE. But, I was thinking more, Congressman, of the idea of possibly the SBA forming an internal loan committee.

If I understand correctly how the SBA works right now, individual loan officers are more or less responsible for their own portfolios, and it may be that if the burden of that responsibility is shared, that there is less pressure on each individual.

Making decisions on whose loans are approved is difficult and it may be helpful to the SBA to have that kind of internal support in their own offices.

Mr. STENHOLM. I think that may be a very good idea. Can you suggest to the Congress how we can bring interest rates down?

Ms. GEBALLE. Yes, but suggestions would be mine and they may not represent the Governor's office so I probably shouldn't say them.

Mr. STENHOLM. OK. I won't press that one any further.

Mr. SKELTON. Thank you. Congressman Vandergriff?

Mr. VANDERGRIFF. One observation, and one question. The observation, my legislative aide and I think that the House has passed H.R. 4773.

Ms. GEBALLE. I understand that it's been passed and that it's ready for the President to sign and there is some question about whether he will sign it.

Mr. VANDERGRIFF. I see. Well, we wanted to be sure that we were correct in that assumption.

Ms. GEBALLE. The House and Senate both have passed it.

Mr. VANDERGRIFF. I was an original cosponsor of that measure. So, we tried to follow that legislation rather closely.

All right. The question has to do with one statement you made relative to an inconsistency among SBA offices in their lending policies. Could you enlarge upon that somewhat?

Ms. GEBALLE. Well, I can to a limited extent. The SBA sets very broad policy guidelines concerning what kinds of loans will be made and how they are to be made. Within each SBA office, it's up to the loan officers to approve or deny loans based on the policy of that office or that particular loan officer. There is a tremendous amount of discretion.

So, I don't view discretion as a bad thing; it's just a fact of life, and when you're in Texas and dealing with six different offices, you have to learn what each office will accept or not accept as a credit worthy applicant. It varies tremendously.

Mr. VANDERGRIFF. I see.

Mr. SKELTON. Call time.

Ms. GEBALLE. Thank you very much.

Mr. SKELTON. Thank you.

Our next panel, I will urge you to stay within your time limit. We are doing well.

Panel 7, deals with telephone access charges. We have Mr. Brown, Mr. Farmer, and Mr. Gibson and Mr. Fuhrman, whose testimony is being submitted.

I might also make this announcement that the testimony from you gentlemen, as a result of a suggestion from Congressman Sten-

holm, is going to be made part of the telephone access charge task force. Let me read this letter from Congressman Ron Wyden, who is the chairman of the special task force on telephones within the Small Business Committee.

Mr. Charles Stenholm has suggested that you accept testimony concerning small business telephone issues during a hearing of your Subcommittee on July 11, 1984. I think it is a useful approach considering the limited time available to investigate the issue. As chairman of the telephone task force, I authorize you to accept testimony for the record on behalf of the task force on July 11, 1984. With warmest regards, Ron Wyden.

A special thanks to your Congressman Stenholm, for the recommendation.

Please proceed with Mr. Brown. Mr. Brown?

Mr. BROWN. Yes, sir.

Mr. SKELTON. We have a 5-minute time limit which hopefully will give us time for some questions. Please proceed, sir.

TESTIMONY OF B. BROWN, FRANCHISEE FOR MUZAK, INC.

Mr. BROWN. Representative Stenholm, Mr. Chairman and members of the committee, I am B. Brown. I am the Muzak franchisee in Abilene, TX. I have operated this franchise since 1966. With your permission, I submit the prepared statement, and I would be pleased if it would be included in the record of this hearing.

Mr. SKELTON. It has previously been stipulated.

Mr. BROWN. I have it here. Do you want it now?

Mr. SKELTON. Do you have copies for us?

Mr. BROWN. Yes. How many do you need?

[Pause.]

Mr. SKELTON. Please proceed, sir.

Mr. STENHOLM. Mr. Chairman, we need to move the microphone over.

Mr. SKELTON. Yes, would you put the microphone over closer? That goes for all of you.

[Pause.]

Mr. BROWN. Since this is an inquiry relating to small business, it is fitting that we who serve fewer than 100 Muzak subscribers or customers have this opportunity to comment on the effects of rate increase proposals being made by AT&T and Bell operating companies for private line services.

Muzak franchisees depend to a significant extent on the availability of leased telephone lines for local distribution of the Muzak program service for their subscribers. Abilene, and a number of other franchise cities, depend 100 percent on this method of distribution.

In such cities, no alternative method is yet viable. This same statement might be made about the services provided by telephone answering service companies, security alarm service companies, independent music operators, and perhaps many others.

1984 is the fiftieth anniversary of the Muzak program service. Muzak franchisees have utilized the private line services of these same telephone facilities since the beginning of such Muzak franchise operations.

Under the present tariff structure, the telephone company charges represent a significant percentage of our operating ex-

pense. Consider the proposed tariff structure with new rates that would increase those charges as much as 550 percent to 10,106 percent.

I submit to you, and for this record, that even an increase of 100 percent would be devastating to our operation, and I feel certain that it would be very damaging to other small business franchisees.

An increased rate structure for the telephone company would not, and could not, provide an increased or enhanced service for Muzak franchisees. The telephone company would not be required to invest in labor, equipment, increased overhead, or even advertising and promotion. The telephone company would make only one change, the amount charged on the bill. Additionally, we feel the new rate structure was proposed, in a covert manner, in a series of voluminous and incomprehensible filings contemplating that these drastic, exorbitant, and unjustified rates might be overlooked and become law before being found and identified. We believe such rates are in violation of the Communications Act of 1934, and we hope somebody will verify that.

In conclusion, the proposed increases are unconscionable, bear no relation to telephone company costs, and will result in the complete loss of our Muzak business, herein described. While I recognize that this is no place for a dramatic appeal, I do find it very disturbing to contemplate the possible loss of our business in such a manner.

We welcome this committee's oversight and control in this matter.

Thank you.

[Mr. Brown's prepared statement follows:]

PREPARED STATEMENT OF B. BROWN, FRANCHISEE FOR MUZAK, INC.

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Mr. SKELTON. Thank you very much, Mr. Brown. Your testimony parallels the information we have been receiving from your colleagues in the State of Missouri.

Mr. Farmer.

Mr. FARMER. Do you have a copy of my testimony?

Mr. SKELTON. Yes, we do.

TESTIMONY OF DERRELL L. FARMER, MANAGER, TAYLOR TELEPHONE COOPERATIVE, INC., ON BEHALF OF TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC., AND NATIONAL TELEPHONE COOPERATIVE ASSOCIATION

Mr. FARMER. Since we only have 5 minutes, I would like to go on to page 2.

The FCC's access charge decision, which was last amended in January 1984, has shifted the cost of toll onto the end users. The purported goal of this dramatic change in telephone pricing is to keep larger business users on the public telephone network, and thereby increase economic efficiency. Yet, the Commission has admitted it does not have conclusive evidence that large users will not bypass the public network even if end user access charges are imposed.

The FCC insists that this plan can be carried out without any significant subscriber dropoff. Yet, it has never conducted its own thorough examination of potential dropoffs, but has instead relied on industry financed studies.

We, in rural America, feel the Commission is helping large telephone users at the expense of rural subscribers, both business and residential. There will be subscriber dropoff in rural America because interstate access charges, coupled with local rate increases, will make basic telephone service prohibitive. The level of assistance recommended by the joint board in Docket 80-286, and which the FCC considers adequate to assist high cost telephone systems is not sufficient. NTCA believes high cost telcos should recover 100 percent of nontraffic sensitive costs over 110 percent of the national average.

Moreover, the method for calculating a company's cost in order to determine eligibility for high cost assistance under the FCC's plan penalizes telephone systems which are REA borrowers because it lowers their cost relative to those of non-REA borrowers.

Under the joint board's formula, national nontraffic sensitive or fixed plant costs are calculated using a national average cost of debt. For consistency and fairness, we believe the national average cost of debt should be used. NTCA has made these views known in recent comments in ongoing proceedings in the access charge and joint board dockets.

The Commission has said the long-term benefits of access charges will outweigh its short-term hardship on some subscribers. FCC Chairman Fowler has pointed to the 6.1-percent reduction in long-distance rates as an example of such a benefit.

Mr. Chairman, our subscribers, like most rural subscribers make mostly intrastate long-distance calls, if they make any long-distance calls. If the FCC implements a $2 access charge per month for resident subscribers, which is proposed now for June 1, 1985, our subscribers would have to make at least $35 interstate or interlata per month toll charges to break even, with 6.1-percent reduction on interstate long-distance calls. A very small portion of our subscribers would realize a savings. Of our 5,000 subscribers, they only average $29.33 per month on all long-distance calls.

We would recommend that if these charges are due from anyone, let's add them to the carriers of toll. First of all, these charges are related to interstate jurisdiction controlled by the FCC and the local loop and local subscriber should be controlled by the State regulators.

In a recent survey conducted by the National Federation of Independent Businesses, two-thirds of those responding stated that less than half of their phone bills represented long-distance charges. In addition, over half of their long-distance calls were intrastate. Clearly, rural businesses and, therefore, rural communities will not benefit from long-distance rate reductions. Yet, small businesses are paying exorbitant charges for access to long distance.

The first end user charges for multiline business customers was implemented May 25, 1984. A survey of the charges to Taylor Telephone subscribers proves that rural subscribers are bearing an unfair burden under the FCC's plan.

We have 51 small business subscribers with a total of 149 access lines in our system. The cost of the access charge is $894. The reduction of the toll amounted to $359.67. This toll study shows that due to access charges being added to multiline subscribers, these 149 subscribers paid approximately $3.59 more per line with the addition of access charges less the rate reduction than they would have if no changes had taken place. Of these 51 subscribers, only 4 had a savings, and it was very minimal. See exhibit 1.

As you know, many States have considered or are considering mirroring the FCC access charge scheme. The Texas Public Utilities Commission has strongly opposed end user access charges because it believes they pose a threat to universal service.

In its decision, the Texas Public Utilities Commission recognized that those of us serving high cost, low density areas will be hurt most by the reduction in toll revenues caused by divestiture.

[Mr. Farmer's prepared statement with attachments follows:]

PREPARED STATEMENT OF DERRELL L. FARMER, MANAGER, TAYLOR TELEPHONE COOPERATIVE, INC., ON BEHALF OF TEXAS STATEWIDE TELEPHONE CO-OPERATIVE, INC., AND NATIONAL TELEPHONE CO-OPERATIVE ASSOCIATION

Good morning, Mr. Chairman and Members of the Committee. My name is Derrell L. Farmer and I am the Manager of Taylor Telephone Cooperative, Inc. in Merkel, Texas and President of the Texas Statewide Telephone Association. Today I also represent the National Telephone Cooperative Association, and TSTCI.

NTCA is a national trade association comprised of approximately 450 locally owned and operated small telephone systems providing service in rural areas in 42 states. Most of these systems have obtained capital financing under the loan programs of the Rural Electrification Administration (REA).

The Texas Statewide Telephone Cooperative,Inc., is an organization consisting of twenty-four member telephone cooperatives serving an approximate 100,000 subscribers in predominatly rural areas and small communities within the State of Texas and the Panhandle of Oklahoma.

These cooperatives were organized to serve the rural areas of the State as the only means for the rural people to receive telephone service. The Bell System and the major independent telephone companies were unable or unwilling to serve these economically unprofitable areas. The areas served by our cooperatives have an average density of only 2.01 main stations per route mile. These range from a low of .58 per mile to a high of 5.46 per mile. This is in comparison with 9.34 for all REA borrowers and to over 27 main stations per route mile for Southwestern Bell - Texas. The investment per main station ranges from a low of $1,704 to a high of $6,246 with the average being almost twice that of all REA borrowers combined, and almost three times that of the Bell System.

Taylor Telephone serves 5,000 subscribers along 2,208 route miles of cable, which is an average of 2.26 subscribers per mile. We serve parts of nine counties surrounding the Abilene and San Angelo areas. Our service area covers 1,966 square miles. We have a total investment in cables, buildings, and equipment of $12,608,184.00 (twelve million six hundred eight thousand one hundred eighty four)- that equals to $2,521.64 per subscriber. Taylor Telephone's average income from local service is $11.57 per month and $29.32 per month from toll. If they keep eroding income from our toll, you can see what it will do to our local rates.

II. ACCESS CHARGE DECISION

The FCC's "Access Charge Decision", which was last amended in January, 1984, has shifted the cost of toll onto the end-users. The purported goal of this dramatic change in telephone pricing is to keep large business users on the public telephone network and thereby increase economic efficiency. Yet the Commission has admitted it does not have conclusive evidence that large users will not bypass the public network even if end-user access charges are imposed.

The FCC insists that this plan can be carried out without any significant subscriber drop-off. Yet, it has never conducted its own, thorough examination of potential drop-offs; but has instead relied on industry-financed studies.

We in rural America feel the Commission is helping large telephone users at the expense of rural subscribers - both business and residential. There will be subscriber drop-off in rural America because interstate access charges, coupled with local rate increases will make basic telephone service prohibitive. The level of assistance recommended by the Joint Board in Docket 80-286, and which the FCC considers adequate to assist high cost

telephone systems is not sufficient. NTCA believes high cost telcos should recover 100% of NTS cost over 110% of the national average. Moreover, the method for calculating a company's cost in order to determine eligibility for high cost assistance under the FCC's plan penalizes telephone systems which are REA borrowers because it lowers their cost relative to those of non-REA borrowers. Under the Joint Board's formula, national non-traffic sensitive (NTS) or fixed plant costs are calculated using a national average costs of debt. For consistency and fairness, we believe the national average cost of debt should be used. NTCA has made these views known in recent comments in on going proceedings in the Access Charge and Joint Board dockets.

The Commission has said the long term benefits of access charges will outweigh its short term hardship on some subscribers. FCC Chairman Fowler has pointed to the 6.1% reduction in long distance rates as an example of such a benefit. Mr. Chairman, our subscribers, like most rural subscribers make mostly intrastate long distance calls, if they make any long distance calls.

If the FCC implements a $2.00 access charge per month for resident subscribers, which is proposed now for June 1, 1985, our subscribers would have to make at least $35.00 Interstate or Interlata per month toll charges to break even - with 6.1% reduction on interstate long distance calls. A very small portion of our subscribers would realize a savings. Of our 5,000 subscribers, they only average $29.33 per month on all long distance calls.

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We have 51 small business subscribers with a total of 149 access lines on our system. The cost of the access charges is $894.00. The reduction of the toll amounted to $359.67. The difference between the rate reduction cost and the charge to 149 access lines is $534.33. This Toll Study shows that due to access charges being added to multi-line subscribers these 149 subscribers paid approximately $3.59 more per line with the addition of access charges less the rate reduction than they would have if no changes had taken place. Of these 51 subscribers only 4 had a savings, and it was very minimal (see Exhibit I).

As you know many states have considered or are considering mirroring the FCC access charge scheme. The Texas Public Utilities Commission however, has strongly opposed end user access charges because it believes they pose a threat to universal service.[1] In its decision the Public Utilities Commission (PUC) recognized that those of us serving high cost, low density areas will be hurt most by the reduction in toll revenues caused by divestiture.

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[1]Texas P.U.C. Docket No. 5113, Proposed Order and Examiner's Report, April 3, 1984, P. 48.

III. OTHER UPWARD PRESSURES

A. Reduced Toll Revenues

Under deregulation, small rural telcos revenues are being diminished. Specifically, separations changes will reduce our revenue from toll business. In addition, we will no longer receive settlements for terminal equipment, since it was deregulated. In large states like Texas, telcos will receive less revenue from the toll pool, since local exchanges would recover for short distance (or short haul) toll, not the more profitable long-distance (long haul) toll. Also, we will no longer recover revenues for station connections.

The impact of these revenue losses is still uncertain. What is certain is that local customers will have to make up the difference.

B. Toll Rate Averaging

All low-density toll routes, such as those in rural areas, benefit from our current national policy of toll rate averaging. Toll rate averaging is a pricing concept whereby a customer pays equally for interstate calls across equal distances, time of day and duration. There are clear indications that a move to deaverage toll rates is imminent.

Toll rate deaveraging would have a dramatic effect on rural toll rates since a rural toll link costs six times as much as an equivalent urban toll route. AT&T has indicated in FCC proceedings on long-term deregulation of AT&T that it would seek deaveraging under certain circumstances. Like airline deregulation, toll rate deaveraging will further isolate rural America.

Rural users throughout the country have local calling areas with fewer telephones to reach than urban users. Consequently, rural users are more dependent on long distance service to reach essential services such as doctors, hospitals, schools, etc.

NTCA believes legislations should address the higher cost of rural toll connecting links. We urge Congress to include in universal service legislation an explicit statement of support for continued averaging of toll rates nationwide. If legislation is adopted to provide for carrier access charges, provisions should be made to protect deaveraging of toll rates in high cost areas.

C. Burdensome Regulation

Under Section 2(b) of Title II of the Communications Act, small exchange telephone companies, as intrastate carriers, are exempt from many of the FCC regulations and reporting requirements. Unless carefully designed, new mechanisms for recovering local costs may impose heavy new reporting and filing requirements on small companies. NTCA also supports the concept of equal interconnection or equal access, as it is known. However, we urge that economically infeasible requirements for such interconnection not be imposed on small companies with electro-mechanical or older switches. As a minimum, implementation schedules should recognize the technical and financial constraints of small companies and allow flexibility in meeting these standards. NTCA urges Congress in considering common carrier legislation to continue the Section 2 (b) (2) exemption for small local telephone companies.

D. Indirect Pressures

Not only are small, rural telephone systems having to respond to major upheavals in the telephone industry, but simultaneously REA, our main source of financial support, is under attack. A bill to strengthen REA telephone and electric loan programs and afford REA borrowers like Taylor Telephone the flexibility to seek non-government funding, H.R. 3050, passed this body easily in March, 1984. A similar measure, S. 1300, is under intense debate in the

Senate at this time. Moreover, this Administration has been a primary opponent of attempts to ensure the solvency of the REA program, a program which is largely responsible for bringing basic telephone service to rural America. In addition, commercial cable companies are capable of competing for wireline telephone service. Under H. R. 4103, which is pending in the House, they would have a competitive advantage in the area of data transmission.

IV. CONCLUSION

Finally, I would like to point out that rural telephone systems like Taylor Telephone are also small businesses and all end-user access charges impact on our business. When subscriber drop-off occurs due to end-user access charges, industry changes and the various pressures which increase rates, our cooperative loses business. This in turn hurts our community because we contribute greatly to the local economy.

Your constituents, on whose behalf I am speaking to you today, are also our customers. Therefore, we ask you to reverse the movement to an access charge system because it is unfair and also because it does not make economic sense to undermine a major contributor to the rural economy - the telephone system.

We appreciate your concern, Mr. Chairman and all the members of the Committee, and your interest in preserving universal telephone service at reasonable rates. We look forward to working with you to preserve affordable telephone service. Thank you for this opportunity to testify.

Exhibit 1

	Total Toll	Less Intralata	Equals Interlata &Interstate Toll	(Rate Reduction) x 6.1%	No. Access Lines	Cost Each Access Line	Access Charge Amounts	
1.	276.66	96.61	180.05	10.98	3	6.00	18.00	
2.	202.48	63.01	139.47	8.51	5	6.00	30.00	
3.	83.46	22.09	61.37	3.74	3	6.00	18.00	
4.	251.15	83.55	167.60	10.22	7	6.00	42.00	
5.	26.17	2.79	23.38	1.43	2	6.00	12.00	
6.	45.15	15.59	29.56	1.80	2	6.00	12.00	
7.	631.90	235.09	446.81	27.26	3	6.00	18.00	9.26
8.	11.54	3.12	8.42	.51	2	6.00	12.00	
9.	211.23	63.23	148.00	9.03	4	6.00	24.00	
10.	172.69	54.21	118.48	7.23	4	6.00	24.00	
11.	1363.72	451.73	911.99	55.63	3	6.00	18.00	37.63
12.	255.19	86.83	168.36	10.27	12	6.00	72.00	
13.	125.87	42.35	83.52	5.09	2	6.00	12.00	
14.	304.90	75.56	229.34	13.99	5	6.00	30.00	
15.	65.10	22.78	42.32	2.58	2	6.00	12.00	
16.	4.35	1.52	2.83	.17	2	6.00	12.00	
17.	218.63	67.93	150.70	9.19	3	6.00	18.00	
18.	471.26	151.05	320.21	19.53	3	6.00	18.00	1.53
19.	29.00	10.15	18.85	1.15	2	6.00	12.00	
20.	131.93	45.35	86.58	5.28	2	6.00	12.00	
21.	103.73	31.17	72.56	4.43	2	6.00	12.00	
22.	26.49	9.27	17.22	1.05	2	6.00	12.00	
23.	254.41	86.21	168.20	10.26	5	6.00	30.00	
24.	413.42	111.72	301.70	18.40	2	6.00	12.00	6.40
25.	72.65	25.43	47.22	2.88	3	6.00	18.00	

	Total Toll	Less Intralata	Equals Interlata &Interstate Toll	(Rate Reduction) x 6.1%	No. Access Lines	Cost Each Access Line	Access Chg Amounts
26.	106.83	31.18	75.64	4.61	2	6.00	12.00
27.	160.51	46.47	114.04	6.96	2	6.00	12.00
28.	84.80	27.32	57.48	3.51	2	6.00	12.00
29.	187.36	51.47	135.89	8.29	2	6.00	12.00
30.	27.85	9.75	18.10	1.10	2	6.00	12.00
31.	55.92	19.58	36.37	2.22	4	6.00	24.00
32.	.98	.34	.64	.04	2	6.00	12.00
33.	116.95	40.93	76.02	4.64	2	6.00	12.00
34.	34.22	11.98	22.24	1.36	3	6.00	18.00
35.	5.42	1.90	3.52	.21	2	6.00	12.00
36.	88.16	30.19	57.97	3.54	2	6.00	12.00
37.	105.87	37.05	68.82	4.20	2	6.00	12.00
38.	114.56	40.10	74.46	4.54	2	6.00	12.00
39.	504.98	154.47	350.51	21.38	6	6.00	36.00
40.	56.43	17.13	39.30	2.40	2	6.00	12.00
41.	137.81	46.66	91.15	5.56	2	6.00	12.00
42.	33.67	6.74	26.93	1.64	2	6.00	12.00
43.	193.12	57.27	135.85	8.29	2	6.00	12.00
44.	131.67	42.58	89.09	5.43	2	6.00	12.00
45.	120.14	41.53	78.61	4.80	3	6.00	18.00
46.	33.23	11.64	21.59	1.31	5	6.00	30.00
47.	12.13	4.24	7.89	.48	2	6.00	12.00
48.	154.12	53.19	100.93	6.16	2	6.00	12.00

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	Total Toll	Less Intralata	Equals Interlata &Interstate Toll	(Rate Reduction) x 6.1%	No. Access Lines	Cost Each Access Line	Access Chg. Amounts
49.	258.05	62.68	195.37	11.92	3	6.00	18.00
50.	112.50	39.29	73.21	4.47	2	6.00	12.00
51.	-0-	-0-	-0-	-0-	2	6.00	12.00
	Estimated Toll Reduction			359.67	149		894.00

The cost of the access charges $394.00
Reduction of the toll amounted to 359.67

Difference between the rate reduction cost and the charge to access to the total 149 lines. $534.33

149 Subscribers divided into $534.33

This Toll Study shows that due to access charges being added to multi-line subscribers these 149 subscribers paid approximately $3.59 more per line with the addition of access charges less the rate reduction than they would have if no changes had taken place.

costs and densities that exist anywhere in the country. Before we completely dismantle the existing pooling and settlements arrangements, we need to know the effect such a change on all the local exchange companies in the state. Rather than risk the loss of any of the local exchange companies to the vagaries of the so-called competitive marketplace, the examiners agree that intraLATA toll pooling should continue at least for 1984 and 1985. The examiners note parenthetically that the OCCs' concern over whether the local flat rates of these small companies should have increased in order to recover more of the NTS costs can generously be described as premature at best, since only a few local exchange companies had any OCC interconnections at the time of the hearing in this docket. If intrastate toll rates have increased in order to recover NTS costs which, according to the OCCs, should have been recovered in local flat rates, that has simply worked to their benefit, since the OCCs base their enterprises on their ability to underprice the end-to-end toll services of the traditional toll partnership.

III. Opinion and Recommendation

Although the parties fought each other on virtually every issue, the examiners have discussed only the major issues presented in this docket. The exchange companies and the interexchange carriers disagreed on just about everything, except the fact that local subscribers should pay end user access charges. With the exception of TSTCI, these parties were more than willing to impose end user access charges on local subscribers almost without regard to other regulatory events which create different--but equally potentially damaging to universal service--upward pressures on local rates.

The OCCs in particular attempted to cast themselves simultaneously in the roles of victim (ordinary business customers being unjustly forced to "subsidize" the local exchange companies--by paying part of the NTS costs of local exchange plant and facilities they use in competing with the providers of their local connections and with each other) and hero (bringing the benefits of competition to Texas consumers--but only if they are lucky enough to live in high density, high traffic areas, and make a relatively high number of toll calls on a regular basis). The overwhelming impression created by the OCCs which were parties to this docket is that the future of telecommunications in this state will be characterized--and jeopardized--by the same sort of posturing and invective offerred as a substitute for evidence in this docket, and the self-defeating refusal to acknowledge that all providers of telecommunications have, or should have, a commonality of interest in the preservation and promotion of universal service in Texas.

The examiners have considered the arguments advanced by every party to this docket and weighed the evidence offered in support thereof. Because the examiners believe that the preservation of universal service in this state

remains the paramount policy consideration and the cornerstone of the regulation of telephone service in Texas, and because the imposition of end user access charges is a threat to such universal service, the examiners have recommended that no end user access charges be imposed in 1984, and that any increase in local flat rates on the basis of intrastate costs must be the result of a hearing.

Furthermore, the examiners support the staff's proposal in all respects save three, the first being that intrastate settlements should be based on return on equity beginning January 1, 1984. The examiners do not necessarily agree or disagree with that recommendation; however, the staff witness himself agreed on cross-examination last November that there was probably not adequate time to develop such a plan prior to January 1, 1984, and the proposal drew heavy criticism from TSTCI. The examiners feel that additional examination of the staff's proposal is warranted and should be included in the scope of the inquiry recommended and discussed below. The other staff recommendations which the examiners would alter is the basis on which the ICAC is calculated and the pooling of TS access charges. These departures from the staff's proposal will be discussed in greater detail below.

The examiners recognize that the staff's proposal is not the one favored by either the local exchange companies or the interexchange carriers; however, the Commission staff has developed a plan for implementing access charges in Texas on an equitable basis for all interexchange carriers which, in the examiners' opinion, also causes the least disruption to the operations of the local exchange companies and to the high level of universal service in Texas. While the staff proposal that parity access charges be implemented for the recovery of TS costs and some NTS costs is not based on implementation of rates which would be designed to recover Texas-specific costs, even using separations methodologies, it has the advantage of being available relatively quickly. The examiners agree that Texas access rates should be based on Texas costs, but the exchange companies can hardly be faulted for being unable to predict the outcome of the perennially pending cost studies docket which might have provided some guidance on the type of cost studies the Commission would find acceptable for pricing various services. The examiners also point out that while the Commission staff's proposal is not perfect, that does not mean it is so flawed that it should not be implemented, as the OCCs would have the examiners hold. On the contrary, implementation of an access charge structure which requires all interexchange carriers to contribute equitably to NTS costs recovery is certainly much less discriminatory than the present access compensation arrangement under which AT&T is the only interexchange carrier providing such support, and is therefore preferable to the present plan.

In addition, there are unfortunate--but hardly minor--potential results of implementing non-parity level access charges. As GTSW's witness Richard Funk

testified, GTSW performed live monitoring of some interexchange carriers' intrastate interconnections. The results of this monitoring revealed that some interexchange carriers, which ordered and paid for only intrastate lines, carried interstate traffic over them but did not report it as interstate traffic. The examiners certainly do not take this testimony as evidence of even widespread misreporting, much less of systematic fraud; nothing in this record even remotely indicates that kind of activity by interexchange carriers. Nevertheless, the testimony does demonstrate that the rate disparity between interconnections used for intrastate and interstate traffic which are frequently the same facility could create a powerful incentive for misreporting. Furthermore it is not the examiners' position that any interexchange carrier would intentionally misreport its traffic given even the slightest incentive to do so--if anything, the interexchange carriers participating in this docket appear to be scrupulous about jurisdictional reporting even though present rate disparities are significant; however, some interexchange carriers have misreported--unintentionally or intentionally--some traffic over some connections, and the potential for underrecovery of exchange company revenue requirements does exist. Implementing access rates at the intrastate level at parity with interstate rates would obviate the necessity of imposing potentially burdensome monitoring or reporting requirements on exchange companies, interexchange carriers, or both, in addition to the massive restructuring of access tariffs and rate elements which is being recommended by the examiners.

The examiners are recommending that the Texas access tariffs should be in parity with the interstate access tariffs as filed with the FCC which incorporate the changes ordered by the FCC in its February 15, 1984, order in CC Docket No. 78-72 and its February 17, 1984, order in CC Docket No. 83-1145, with two exceptions. The first exception to parity is that no end user access charges--not even for multi-line business customers--should be authorized. Instead, an ICAC rate element as recommended by the Commission staff (but calculated and assessed on a minute-of-use basis rather than as a flat rate) should replace the end user access charge rate element. Although it is possible that no interstate access charge tariffs will be in place as of the Final Order Meeting at which this Examiners' Report will be considered, the examiners are of the opinion that it is in the public interest to implement some access charge structure as soon as possible rather than delay a final order herein indefinitely until the FCC acts on the interstate tariffs. The changes required by the FCC in its orders of February 15 and 17 are reasonable and implementation of those changes (with the exception of the Special Access tariff discussed below) will still provide an equitable NTS cost contribution from the interexchange carriers. If the interstate access charge tariffs as finally adopted by the FCC differ significantly from the intrastate tariffs filed pursuant to a final order in this docket, that issue can be addressed in the access revenue requirement dockets recommended by the examiners and discussed below.

Second, parity with the Special Access section of the interstate tariff will not be authorized for any local exchange company unless that local exchange company's interstate Special Access tariff (or one in which it concurs) has been approved by the FCC by the time this Examiners' Report comes up for consideration at a Final Order Meeting of this Commission. The FCC found, in paragraphs 48-49 of the February 17 order in CC Docket No. 83-1145, that the proposed Special Access rate structure was unreasonable and discriminatory and would have to be replaced. The FCC expects that by March 15, new Special Access tariffs will have been developed and filed in order that they can go into effect April 3, 1984. However, there is the possibility that the ordered changes cannot or will not be made in time, or that further changes could be ordered by the FCC. If no interstate Special Access tariffs are in effect by the time this Commission must enter a final order herein, the examiners recommend that the local exchange companies resume their concurrence in the intrastate private line tariffs as they existed prior to divestiture or as such tariffs are changed pursuant to a final order in Docket No. 5220. Any local exchange company desiring not to concur in the intrastate private line tariffs but to implement its own intrastate private line tariff would be required to submit such a tariff in a rate case.

The examiners acknowledge that the course of action recommended here is perhaps not the one they would recommend if every nuance of the FCC's current proposal could be explored in further proceedings in this docket and if Texas-specific cost data were presently available. The recommendation that an access structure for Texas be based on parity with the FCC's structure is merely a good starting point, not a blanket endorsement of every element of that structure. The examiners stress that this Commission is in no manner obligating itself to adopt without question every FCC rate and structure for access. The exigencies of the present situation, however, simply outweigh other considerations and require that some type of access tariff be implemented in Texas; the parity structure is available for use fairly quickly and the intrastate tariffs will involve relatively few changes from the interstate tariffs. No doubt the parties here will avail themselves of every opportunity to fine tune the various provisions of those tariffs in future proceedings. The examiners conclude that implementation of parity tariffs to the extent recommended herein will result in a rate structure for interexchange carriers which is neither unreasonably discriminatory against AT&T nor unreasonably preferential in favor of the OCCs and is therefore reasonable and appropriate.

The centerpiece of the staff's proposal is the ICAC--Interexchange Carrier Access Charge--which functions as a substitute for the end user access charge, but may or may not recover the same revenue as would mirrored or parity end user access charges. As the staff originally proposed it, the ICAC was to be calculated as a flat monthly charge to each interexchange carrier based on the number of local customers that use the exchange companies' plant to access that

carrier's services. For FG-A, the ICAC was to be based on the number of access codes representing customers authorized to originate calls from cities in Texas. For FG-B and FG-C, the ICAC was to be based on the number of lines programmed to permit access. If a subscriber uses more than one interexchange carrier, the ICAC would be applicable more than once, and the calculation of the revenue requirement was to be made with this multiple application in mind. The examiners agree that an ICAC is necessary to permit the exchange companies to recover the revenue which would otherwise have been recovered through end user access charges. However, pursuant to the Examiner's Interim Order of November 23, 1983, the local exchange companies calculated the ICAC as a minute-of-use rate based on the pooled residual of the make-whole revenue requirement of all local exchange companies. Because the companies have already calculated and imposed the ICAC on a minute-of-use basis, the examiners recommend that the ICAC continue to be a uniform minute-of-use charge calculated on a pooled revenue basis separately from the intraLATA toll pool.

The examiners also depart from the staff's recommendation that revenue from premium access and from mirrored traffic sensitive charges for the High Cost Factor be pooled by those local exchange companies concurring in intrastate access tariffs. The local exchange companies are not presently pooling such revenues pursuant to the interim access charge tariffs and the examiners therefore recommend that, as with the continuation of the interim procedure for calculating the ICAC, the interim non-pooling of TS access charges not be altered. The examiners recommend that only NTS access charges--that is, the Carrier Common Line and "Interexchange Carrier Access Charge rate elements"--be pooled. The NTS access charge revenues should be pooled separately from intraLATA toll, which is discussed below.

The staff's proposal also includes recommendations that the Commission reconsider the continuation of intraLATA toll pooling prior to 1986 and review in 18 months the effects on the local exchange companies of interstate and state separations changes and access charge implementation. The examiners agree that further investigation of the issues associated with intraLATA toll pooling is warranted and strongly urge that an inquiry be instituted as soon as possible so that the review will be finished prior to 1986. That inquiry should address a number of questions regarding various NTS cost recovery mechanisms which revolve around two basic scenarios. The first scenario assumes the elimination of intraLATA toll pooling and the application of access charges to all toll services in order to explore whether this would necessitate deaveraged rates and, if so, the impact of such deaveraging on local exchange companies, interexchange companies and subscribers; other issues attendant on the elimination of pooling would also be addressed. The second scenario assumes the continuation of intraLATA toll pooling but would examine various alternatives to the present pooling and settlements arrangements, such as settling on return on equity instead of return on rate base; using an intrastate

separations formula--the one proposed by the staff in this docket or an alternative developed by some other party--instead of continued use of interstate separations formulas and procedures. The inquiry should also explore whether a state High Cost Factor (HCF) and Universal Service Fund are necessary and if so, how the HCF should be developed and applied, given the considerations outlined in Mr. Land's testimony (Staff Ex. No. 5, pp. 8-11, 17-18).

The examiners recognize that a great deal of the frustration experienced by all participants in this docket was caused by the inability to identify Texas-specific costs. As pointed out previously, the local exchange companies have not received specific directives from this Commission regarding appropriate cost study methodologies. Docket No. 2944 was instituted in November 1979; briefs were submitted three years ago. In all likelihood, the factual circumstances on which that proceeding was based have changed over time, if for no other reason than that divestiture has occurred. It is apparent that in the absence of a clear mandate from this Commission, the exchange companies will continue to rely on separations methodologies and procedures for deriving intrastate costs and for assigning such costs to interLATA access, intraLATA toll and local exchange. The examiners therefore urge the Commission to engage an outside consultant to work with the staff and the local exchange companies to develop appropriate cost studies for identifying Texas-specific costs in order to establish intrastate access charge structures and rates. The examiners contemplate that such cost studies should identify all intrastate costs, both TS and NTS, for local, intraLATA and interLATA services, if such cost studies are possible at all.

The final recommendations of the examiners involve the procedures for reviewing the access revenue requirements for exchange companies, which are presently calculated as the revenue needed to replace lost toll revenues--the "make-whole" revenue requirement--pursuant to the interim order in this docket. Since the largest access revenue requirements will be associated with the largest local exchange companies--SWB, GTSW, Centel, Continental, and United/Palo Pinto--it seems appropriate to deal with these companies not only separately from all the other exchange companies but separately from each other as well. SWB's present access revenue requirement will be determined in Docket No. 5220. Since GTSW has a rate case presently pending (Docket No. 5610), it would seem to be more efficient to review its access revenue requirement in the rate case instead of in a separate proceeding. The examiners suggest that the General Counsel institute at least four new inquiry dockets--in lieu of a second phase in Docket No. 5113--for the purpose of reviewing access revenue requirements: one each for Centel, Continental, and United/Palo Pinto, and one for all other local exchange companies, with the qualification that the docket for all other local exchange companies could be further segregated between Average Schedule settlement companies and cost settlement companies. The examiners further recommend that in the absence of Texas-specific cost data,

access revenue requirements for these companies should be determined using separations methodologies and should not be based on the net lost toll revenue. These access revenue requirements should be developed using standard rate case procedures to derive a historical test period. The examiners recommend that the historical test period be the most recent twelve month period for which there is actual data, and suggest that the companies be given sixty days from the date of the final order in this docket to develop and file the tariffs based on this historical data and to establish the NTS access charge pool. The new tariffs should be allowed to go into effect after review by the Commission staff, since the four inquiry dockets will be the forums for reviewing the new access tariffs and the revenue requirements on which they were based.

The examiners further recommend that since the interim access charges must remain in effect until the new tariffs are approved, the calculation of any refunds be handled as follows. The books on the interim access charges should close no later than sixty days from the implementation of the approved tariffs. The local exchange companies would then have ten days to calculate any refunds which might be due interexchange carriers and file their statements of refunds along with supporting documentation with the Commission and with the interexchange carriers. The examiners also would require the local exchange companies to allow the interexchange carriers to audit the back-up work papers on the refund calculations prior to the refund statements being filed. The entities which calculated and filed the interim access tariffs should calculate and file the refund statements; that is, those local exchange companies whose interim access tariffs were developed and filed by the Texas Exchange Carriers (TEC) should have TEC develop and file the refund calculations and statements.

Along with the refund statements, each local exchange company should also file a plan for making any refunds which may be due if that local exchange company is unable to make the refunds in a single lump sum payment. In any event, the refunds should commence no later than thirty days after the refund statements are filed.

If the new tariffs result in access charges which are higher than the interim access rates, the examiners are not reccmmending that that new rates be made retroactive until January 1, 1984. The examiners further recommend that should any exchange company file a rate case during the pendency of these access revenue requirement inquiry dockets, that exchange company's access revenue requirement should then be severed from the inquiry and considered in the rate case.

The examiners agree that access charges should not apply to RCCs at this time; however, there is nothing about the way RCCs use local exchange plant to originate and terminate calls which distinguishes such use from the use OCCs make of the same plant. It may be questionable whether the distance the RCC

carries the traffic (that is, whether such traffic is "local or interexchange") should have a bearing on whether the use of the plant is for access or not. The examiners recommend that local exchange companies who wish to classify RCC interconnections as access services make such proposals in their next rate cases.

IV. Findings of Fact and Conclusions of Law

The examiners further recommend adoption of the following:

A. Findings of Fact

1. This docket was instituted by the General Counsel of the Public Utility Commission of Texas on April 19, 1983, in a petition for an inquiry into the effects of the Modification of Final Judgment, United States v. AT&T, 552 F.Supp. 131 (D.D.C. 1982), aff'd. sub. nom. Maryland v. United States, 103 S.Ct. 1240 (1983), and the FCC's Access Charge Orders in CC Docket No. 78-72 on the local exchange telephone companies operating in Texas; the General Counsel filed his First Amended Petition for an Inquiry on July 11, 1983.

2. All telephone companies providing local exchange service in Texas were named parties to the docket; AT&T was joined as a necessary party to the docket. The following were allowed to intervene as parties: U. S. Telephone, Inc. (U. S. Tel), MCI Telecommunications Corporation (MCI), Texas Retailers Association (TRA), Texas Association of Telephone Answering Services (TATAS), Southern Pacific Communications Company (Sprint), State Purchasing and General Services Commission (SPGSC), Mr. Jack Sanders, City of Lake Jackson, City of Fort Worth, Texas Municipal League (for which specific cities served by SWB were later substituted as parties), Satellite Business Systems (SBS), City of Dallas, Western Union (which later withdrew as a party), Consumers Union, City of El Paso, City of Amarillo, Texas Association of Radio Systems (TARS), Associated Business Customers, and the Office of the Public Utility Counsel.

3. Protest statements were filed by Directline Todco, Inc.; WesTel, Inc.; Qwest Microwave, Inc.; Directline HASP, Inc.; Telesphere Network, Inc.; Wiese, Inc. d/b/a Texas Long Distance; and Satelco, Incorporated.

4. Prehearing conferences were held in this docket on May 3, June 8, June 23, June 30, July 7, July 14, July 28, August 22 and September 8, 1983.

5. The hearing on the merits convened on September 12, 1983, recessed on October 15, 1983, reconvened on October 24, 1983, and adjourned on November 15, 1983.

Mr. FARMER. Are we running out of time?

Mr. SKELTON. Yes, sir. We'll get back to you with questions, never fear.

Mr. FARMER. OK.

Mr. SKELTON. Mr. Gibson.

TESTIMONY OF JOE B. GIBSON, PRESIDENT, UNITED TELEPHONE CO. OF TEXAS

Mr. GIBSON. Thank you, Mr. Chairman. It is a privilege to be here, and I appreciate being invited.

My name is Joe Gibson. I'm president of United Telephone Co. of Texas.

Mr. SKELTON. Is that a first cousin to the United Telephone operation in Missouri?

Mr. GIBSON. In Missouri, which you are very familiar in your hometown.

The company which operates in Texas, and we're one of the smaller operating groups of what is known as the United Telephone System, which operates in 20 States.

Here in Texas, we serve approximately 96,000 customers. We cover a territory of about 7,300 square miles, and that gives us a mathematical density of about 12 customers per square mile.

Mr. SKELTON. What part of Texas do you operate in?

Mr. GIBSON. Primarily east and central. The areas surrounding and contiguous to Tyler on down through Palestine. We have isolated groups of exchanges down near Houston, around Navasota. Stevenville in Mr. Stenholm's district, Dublin, Hico, Gatesville, northwest of Dallas around Bridgeport, the Possum Kingdon area. That's really low density areas.

Our territory is mostly rural and small town, and I would submit is not unlike the territory served by Mr. Farmer's organization. I filed some prepared comments. I won't attempt to cover those in detail. Much of the information you have seen in other forms, I believe.

But, given the circumstances leading up to the FCC's access charge decision and given the realities of bypass, we fully support the concept of the FCC's end user access charge plan, which is designed to shift some of the nontraffic sensitive costs to the local telephone network to the local jurisdiction.

The heavy burden which is currently placed on the interexchange carriers, principally AT&T, at both the Federal and State levels, has already spawned a large number of companies and organizations, including State government and the Federal Government, to begin to engineer and effect a systematic bypass of the local telephone network.

Now, as the president of a telephone company, I feel a deep and sincere obligation to the customers I serve, and I wouldn't be here today voicing my support for the end user plan if I did not feel that it was in the best interests of our customers and my company in general.

The separation and settlements methodology which existed through the seventies and on into the eighties, and which, in fact, were brought to a close on January 1, 1984, have been good to my

company, and has been exceptionally good to the customers we serve.

Approximately 70 percent of our total revenues come from toll. Although, in fact, those revenues bear little resemblance to the number of calls made and to the money that we collect from customers who make those calls.

The old system involved a degree of logic and made a great deal of sense in a monopoly environment. In fact, the courts ruled in 1941 that some of the costs should be shifted to the local jurisdictions.

The nationwide network was operated as a giant partnership as far as long-distance calling was concerned. It was a partnership in the Federal jurisdiction between some 1,500 independent telephone companies and AT&T. Here in Texas, there was a partnership among AT&T, the Bell operating companies, and the 72 independent telephone companies in the State.

Under this partnership arrangement, all revenues were essentially put into one of two pools. Either an interstate long-distance pool or a State long-distance pool. All of the companies in each of those pools were able to withdraw an amount of money which totally covered their costs for doing the business allocated to the long-distance jurisdiction.

We also earned a rate of return based on the allocated investment in that pool. This included not only the telephone, but the inside wiring, the drop from the telephone pole to the residence or business, and all of the cable and a portion of the central office, leading clear up to our local exchange central office.

To give you an example of the effect it had on us, if we went out to a rural area to repair a telephone, a telephone that was probably worth $19.95, and our repairman took enough time in driving and working that it cost $100 to cover the cost of the work. We collected $70 of that $100 from the toll pool and called it long-distance revenue. Now, that is a very fine system in the environment where you're operating as a total monopoly, and I enjoyed it a great deal.

In other words, approximately 70 percent of our nontraffic sensitive costs and investments were allocated to the long-distance enterprise. Now, in a monopoly environment, a system of this type is not only legal but it's sustainable over a long period of time.

As regulators could and, indeed, chose to allocate costs between jurisdictions in a manner which served some useful and worthwhile social goals, the primary one being that of affording universal telephone service which has been extended to 97 percent of the businesses and the households in the United States.

Now, a lot of people would like to blame the divestiture of AT&T and the Bell operating companies for what seems to be the mess that we're in. The events that led to that decision have been in process for the last two decades. I think the first monumental decision was the private microwave decision in 1959, which allowed private industry to install their own intercity, interstate networks for their own purposes. I have a map that plots all those microwave networks and the Nation is literally just blackened with the number of private networks that have been bypassing the local exchange for many years.

To get a little bit more current, the competitors that have entered the long distance business, particularly are not dumb. They chose to serve the very highly profitable areas. The areas from which the groups of customers are subsidizing the rest of us. Indeed, some of those intercity carriers have been very successful in recent years.

We find ourselves in the situation where the costs to the interexchange carrier in interfacing with the local exchange are so punitive that not only those carriers, but customers are looking for other technological alternatives to avoid using the local telephone company to terminate their long distance calls.

Now, I would disagree with Mr. Farmer to the extent that I think that bypass not only exists today, it has existed for a long time and it's snowballing at a very rapid rate. Once it takes place, it's virtually irrevocable because once the capital investment has been made to provide those facilities, it is unlikely that those entities are going to bring them back if, by chance, our costs become a little bit more affordable.

A number of cities have announced the concept of teleports, which gets the cities and governments into the business of bypassing. I really think in summarizing what I have to say is that bypass is a real threat.

We made our own study as far as small business customers are concerned. The end user access charge we apply to the average key system or small business account in United of Texas amounted to about $10.08. A 6-percent reduction in the long distance revenues that those people spend in a given month is slightly less than $10. In our company, it was virtually a breakeven, and if the 1985 access charge piece is implemented, a further 15 percent reduction in long distance rates will take place.

I think in the long run, the small businesses are going to profit a great deal by the end user plan.

I thank you for your time.

[Mr. Gibson's prepared statement with attachments follows:]

PREPARED STATEMENT OF JOE B. GIBSON, PRESIDENT, UNITED TELEPHONE COMPANY OF TEXAS

Mr. Chairman and members of the Subcommittee, I am Joe B. Gibson, President of the United Telephone Company of Texas, headquartered in Tyler, Texas. I am also on the Board of Directors of the Texas Telephone Association and the Texas Exchange Carriers Association, but my remarks today represent the views of United Telephone Company of Texas only. My company shares the Subcommittee's concern about the need to preserve universal telephone service in this country. We believe, however, that full implementation of the FCC's Access Charge Plan, as presently constituted, is the best method to enable telephone companies to continue to provide service at reasonable rates.

My company, the United Telephone Company of Texas, and its subsidiary the Palo Pinto Telephone Company provides local exchange telephone service and other ancillary services to the local exchange and is one of 72 companies in Texas who jointly provide intraLATA long distance services. United of Texas is one of the smallest of nine

operating groups of telephone companies which compromise what is known as the United Telephone System, operating in 20 states. At year-end '83, United Telephone Company of Texas served 95,054 access lines in over 90 communities, with over 194 million dollars invested in property, plant and equipment, and 845 employees. Total 1983 revenues were 72.9 million dollars.

While we are considered to be the fourth largest local exchange telephone company in Texas, we are dwarfed in size by the two largest companies. Apart from the Bell company there are 71 so called Independents which serve approximately 55% of the geography of Texas. Our company serves 7,830 square miles of territory which gives us a density of approximately 12 customers per square mile. Most of our exchanges are quite small and are comparable to some of the smallest companies in the state.

Before I address specific issues, I think it would be useful to briefly review the economic circumstances that underlie the FCC's end user charge policy.

TELEPHONE NETWORK COSTS AND SEPARATION PROCEDURES

I'd like to begin with the economic characteristics of the telephone network. The basic components of that network, as illustrated in Exhibit A, are:

(1) Customer Premise Equipment (CPE) including the telephone set itself as well as the intra premises or "inside" wiring;

(2) The local loop, or wire, that connects the customer with the local switch;

(3) The local central office, or switch, which performs the basic function of setting up the connection between the called and calling party; and

(4) The long distance network.

The costs characteristics of the telephone network are not homogeneous. CPE, the local loop, and even a portion of the local central office, are facilities dedicated to the use of individual subscribers. The cost of these facilities are independent of how much they are actually used by the customers. To take a simple example, the costs of a basic telephone set is the same whether the customer uses it 24 hours a day or not at all. Because the costs of these facilities are not affected by usage, they are referred to as non-traffic sensitive, or NTS, plant.

The costs of other components of the network, on the other hand, are affected by usage. For example, the capacity, hence the costs, of the local switch and long distance network are a direct function of the customers' calling volumes. Because the costs of these components of network are primarily determined by usage levels, they are referred to as traffic-sensitive plant.

With that background, let's now turn to the separate but related matter of how these costs, and particularly NTS costs, have been recovered from users of telephone services.

Central to this issue are what are referred to as jurisdictional separation procedures. Under our dual system of regulation of the telephone industry, the FCC is responsible for regulating interstate toll service, and the respective state regulatory bodies are responsible for regulating local exchange and intrastate toll services.

Consequently, it has been necessary to allocate or "separate" the costs of the telephone network between the state and federal jurisdictions in order to determine the appropriate level of rates to be charged for state and interstate services. Jurisdictional separations procedures are the cost allocation methodologies that have been developed to accomplish this essential legal function.

At least in principal, the separation of traffic-sensitive plant is relatively straightforward. Because of the costs of this plant are a direct function of usage, it makes economic sense to allocate the costs of this plant between the state and federal jurisdictions on the basis of the relative use by state and interstate services.

The allocation of NTS costs, however, is another matter. As was stated by the US Court of Appeals for the District of Columbia Circuit, in its June 12, 1984 Opinion in NARUC vs. FCC, case number 83-1225 (pgs. 19-20), "(p) plant costs are non-traffic sensitive when they do not vary with the extent to which the facilities are used. The basic cost of installing and maintaining a local loop, for example, remains the same whether the subscriber, or 'end user', uses a loop to make one call or one hundred, and whether those calls are local or long-distance. Some switching costs, on the other hand, are traffic-sensitive. They in fact increase with usage; for example, as more calls pass through the equipment, heavier, or more costly switches must be employed."

Prior to 1943, this essentially economic view of telephone network costs was reflected in separations procedures. Under what was called the "board to board" principle, only the interstate share of long distance facilities (i.e., from toll board to toll board) was allocated to, and recovered from, interstate toll services. Because NTS costs were not

affected by toll usage, those costs were recovered directly from customers through local service charges.

In 1943, however, the FCC adopted what is called the "station-to-station" principle of separations. This principle holds that since interstate services, in a literal sense, "use" the NTS plant of the network, they should be required to help defray the costs of those facilities. Consequently, separations procedures were revised to allocate a portion of NTS costs, including the costs of telephone sets or "stations" as well as the local loop to the interstate jurisdiction.

Since then, the method of allocating NTS costs between the state and interstate jurisdictions has been subject to frequent revision, the effect of which has been to allocate an ever greater proportion of those NTS costs to the interstate services. Under the existing SPF (subscriber plant factor) formula, a nation wide average of 26%, or approximately 11 billion dollars, of the total NTS costs of the network are allocated to and recovered from the interstate toll services. These allocated NTS costs constitute almost 40% of AT&T's total revenue requirements of MTS and WATS services, prior to the implementation of access charges.

THE FCC'S END USER CHARGE DECISION

The existing separations procedure are largely the product of an era of regulated monopoly. With the advent of competition in the interstate long distance market over the past decade, however, the economic fallacy of recovering NTS costs from the interstate toll services revenues has become increasingly apparent.

To place the issue in a more concrete perspective, lets examine the effect of the existing separations procedure at an individual customer level. The average monthly cost of a local loop today is approximately

$26. Prior to the implementation of access charges, the NTS costs allocated to the interstate toll services amounted to an average of about 15¢ per each minute of use.

This arrangement is obviously beneficial for customers making no interstate toll calls, who thereby enjoy a local service for a total price that is some $7 dollars lower because of the contribution being made by the interstate services. However, to the extent the customers do make interstate toll calls, the benefit of the toll contribution to local rates is to varying degrees offset by higher toll rates. For instance, a customer who makes 30 minutes of interstate toll calls will be contributing to the toll charges, $4.50 to cover the NTS cost allocated to interstate toll services, therefore negating most of the $7 reduction in his/her local rates.

Simply put the effect of existing separations procedure is to redistribute part of the cost of local loops among subscribers in a manner proportionate to toll usage. If all subscribers use exactly the same amount of interstate toll usage, the net impact of this practice would be nil. That is, each customer would be contributing, through interstate toll rates, an amount exactly equal to the reduction of local rates made possible by the toll contribution to NTS. (Even then, it should be noted, that the allocation of NTS costs to interstate toll service has the perverse economic effect of overcharging for toll calls and thereby artificially discouraging usage of the toll network.)

In fact, however, a large proportion of interstate calling is accounted for by a very small proportion of telephone service subscribers. To take a fairly typical example, one Bell Operating Company (BOC) reports that 1% of its business customers account for 42%

of its total business MTS revenues, and 10% account for 75% of those revenues.

Thus, the effect of allocating NTS cost to the interstate jurisdiction and recovering those costs through toll charges is to require high volume toll users to contribute to, or subsidize the cost of facilities dedicated to the use of other subscribers. To give an example, a customer making 4,000 minutes of interstate toll calls in a month would be contributing about $600 to the recovery of NTS cost, or about 30 times the cost of the local loop used to serve that customer.

In the era of regulated monopoly, high volume users have little choice; they either paid the going rate, or they didn't use the service. In today's environment, however, competition is providing these customers with an increasing variety of options by which they can "bypass" the local switched network and avoid the subsidy built into the charges for using that network to originate and terminate long distance calls.

The consequences of attempting to maintain the practice of extracting an NTS contribution from toll services, then, is twofold. First, it provides an artificial or uneconomic incentive for large volume users to bypass the network. That is, those customers will be induced to utilize facilities that are less expensive relative to exchange carriers' tariff rates but more expensive relative to the exchange carriers' underlying costs.

Second, absent stringent regulatory controls over bypass, exchange carriers would be confronted with loss of those customers who currently provide a substantial portion of the NTS contribution. Simply put, Local Exchange Carriers will not be able to require high volume toll users to subsidize other customers in a competitive market place.

The FCC's Access Charge Plan was a direct and rational response to the threat of uneconomic bypass. Essentially what the FCC's end user charge plan does is to require that NTS costs be recovered from the causer of those costs - the end user. Not only does this change in the method of NTS cost recovery forestall the threat of uneconomic bypass, but it also moves the industry towards cost-base pricing - a necessary step for the long term viability of local exchange carriers in an increasingly competitive environment.

What is somewhat confusing about the FCC's end user charge plan is that the Commission elected not to alter the proportion of NTS cost allocated to the interstate jurisdiction. However, the fact that NTS costs will continue to be allocated to the interstate jurisdiction and will be recovered through interstate end user charges is largely a matter of form and not substance. From a purely economic perspective, what the FCC's plan does is to simply require that the cost of NTS facilities be born directly by the individual subscribers to whose use those facilities are dedicated.

THE EFFECT OF END USER CHARGES ON SMALL BUSINESS TELEPHONE RATES

The FCC's end users charge plan has elicited considerable concern about the impact of those charges on the small business users. Indeed, the Small Business Telephone Task Force was created to address precisely those concerns.

In responding to those concerns, I would first like to reiterate an essential point. The end user access charge has nothing to do, and should have nothing to do, with whether, or how much, an individual customer uses interstate toll services. From an economic perspective, the end user charge is simply a reflection of the fact that NTS costs are

caused not by toll usage but by the individual customer's, or end user's, decision to subscribe to telephone service, and therefore should properly be born by that customer.

Thus the FCC's end user charge plan requires small business users, like all other users, to do nothing more than to cover the cost of those local exchange facilities provided for their use.

While I appreciate the Subcommittees concern with the impact of end user charges on small business, I believe that concern is not warranted; and that, indeed, the potential impact on this class of subscriber has been grossly exaggerated.

For example, in the territory served by United Telephone Company of Texas there are 2,032 Key System accounts. The profile of these customers is shown in Exhibit B. The average account has 2.4 lines and generates $176 per month for normal long distance calling (message toll service, or MTS), $111 per month for line, equipment and network services, and $22 per month for directory advertising. The average customer, then, generates approximately $310 of revenue per month for the UTT company. Actually, this is conservative because revenues from WATS calling are not included. Based on the revenues just described, these customers account for approximately 44% of the MTS revenues from the business sector.

The profile I have just described compares closely with that described in the recent National Federation of Independent Business petition to the FCC for further reconsideration of end user charges. In that petition, the NFIB deals with the illustrative 2 to 3 line subscriber whose total monthly bill falls between $200 and $500 dollars per month with approximately 25% of that amount going for long distance

calling. Additionally, 55% of its members have annual gross receipts of $200,000 or more.

Returning to the typical UTT small business subscriber, the increasing result from the weighted average UTT multiline business end user charge of $4.20 is about $10 per month. This amounts to less than $121 per year. That increase is mitigated by two factors. One is the recent 6.1% reduction in the interstate long distance rates, which could increase as more of the FCC Access Charge Plan (particularly, residential end user charges) is implemented. The other mitigating factor is the customer's marginal tax bracket. Thus it is possible that the customer would feel no effect at all, or even experience a net decrease in his/her bill if he/she is a heavy interstate user. On the other hand, the cash flow impact upon his/her business will almost certainly be less than $100 per year.

I do not believe that this effect portends financial hardship for the small business sector of the economy. Thus, I urge the Subcommittee not to take any action that would reduce or eliminate the end user charges currently in effect. They are essential for the telephone industry to move from a regulated monopoly environment to a cost-based, competitive arena.

BYPASS

I must emphasize that the alternative to pricing telephone service so as to more closely recover the cost from the cost causer is bypass. In the words of the FCC, "bypass is an actual threat and present danger." (Third Report and Order, released February 28, 1983, in Docket Number 78-72, Phase I, paragraph 107.) The US Court of Appeals for the District of Columbia Circuit recently held that "...the FCC's treatment of the

bypass issue is adequately reasoned..." (Opinion, dated June 12, 1984, in NARUC vs. FCC, Case No. 83-1225, pg. 45).

As that same court noted, Western Union, for example, already has a growing investment of over $100 million in local distribution facilities as part of a specific program to reduce its dependency on the Bell system (pg. 45-47). Some parties have suggested that the problem can be cured by denying potential bypassers permission to construct facilities; but, both the FCC and the Court (pg. 47) rejected this proposal as unsound and unworkable. To the extent that access charges are set at excessive levels, there can be little doubt that interstate users will be encouraged to invest in unnecessary and duplicative facilities. The Court concluded that "...FCC sufficiently established the existence of bypass as a real market force." (pg. 49)

Moreover, once begun, the debilitating effects of bypass will spread. The nature of bypass is that it produces a vicious spiral-effect; that is, the more customers that drop of the network, the more costs that are left for the remaining customers to bear, which will cause higher rates that will force more customers to cancel service, and so on. In other words, all customers need to understand, appreciate and accept the prospect of comparatively moderate increases in telephone rates to cover today's costs of service, in order to avoid virtually prohibitive increases that will surely result in the future if arbitrary and uneconomic incentives to bypass are continued. Otherwise, the telephone industry faces escalating earnings deficiencies, which in private business always eventually leads to financial ruin.

More importantly, it must be recognized that in the environment of interstate access charges, the impact of bypass is not limited to just

those telephone companies which have large customers that leave the local network for alternative communication routes. The interstate Carrier Common Line Charge is calculated, essentially, by dividing the allocated non-traffic sensitive access costs by the forecasted minutes of use. If an exchange carrier is subsequently bypassed, it will obviously not experience or charge for the minutes of use it had expected. Thus, that carrier will pay into the Carrier Common Line Pool less revenues than were anticipated for the year. So long as participation in the interstate Carrier Common Line Pool, administered by the National Exchange Carriers Association, is mandatory for all exchange carriers (under the FCC's Access Charge Plan), all such exchange carriers will effectively be precluded from recovering from the Pool the full authorized rate of return.

Further, since such a result will cause exchange carriers to report higher costs to the NECA in subsequent years, thereby driving the Carrier Common Line Charge higher, more bypass will be stimulated and the opportunity for the Pool to earn the authorized rate of return will be increasingly diminished. In other words, the vicious spiral-effect of bypass can and will eventually adversely impact all exchange carriers.

Even the U.S. Congress has recognized the evil of bypass. A study entitled "The Economic Issues of Changing Telecommunications Industry" was issued by the Joint Economic Committee, to the Congress of the United States, on October 3, 1983. The study written by staff economist Dale Jahr, succinctly states that; "Universal service is jeopardized by both (customer) dropout and bypass, but bypass is the largest threat to the economic feasibility of the public phone network..." "This applies to all areas of the country high cost and low cost alike" (pg. 16-17).

Mr. Jahr has subsequently addressed these same principles in a Staff Study prepared for the Joint Economic Committee of the Congress, dated March 1, 1984, entitled "Public Policy Considerations of Pricing Telephone Services."

The Congressional Budget Office (CBO), Congress of the United States, also addressed these issues in a June, 1984 study entitled "The Changing Telephone Industry: Access Charges, Universal Service, and Local Rates." As has been widely reported, that study does not support the anti-access charge approach that was contained in Senate Bill 1660 and House Resolution 4102. It concluded that such legislation "...might prove difficult to administer and have unintended consequences for the development of new technologies." (page 13). Instead, the CBO suggested that;

"The Congress might choose to take no action and permit the FCC to implement its access charge program. A 'do nothing' approach could be justified for several reasons. First, changes in telephone rates might be viewed as being similar to price changes for other services. While all price changes tend to benefit some individuals at the expense of others, the government does not normally seek to freeze prices in the attempt to protect individuals who might otherwise suffer. Second, the level of access charges now proposed--limited to $4.00 monthly until 1990--might not be considered to be high enough to cause extreme hardship. Third, the FCC has proposed to establish a Universal Service Fund to assist the subscribers of high-cost companies and is now supporting means to exempting low income subscribers from access charges" (pg. 44).

Finally I must refer to the June 12, 1984 opinion of the US Court of Appeals of the District of Columbia Circuit, in the case of NARUC vs. FCC, No. 83-1225. After an exhaustive analysis of all the arguments against the FCC's Access Charge Plan, the Court affirmed the general principles contained therefore in saying that;

"Over five years' study of complex and far-ranging issues set the foundation for the FCC's orders in this case. The Commission predicted industry trends and the impact of rate changes, reconciled widely diverse policy goals and numerous competing interests, and devise solutions to novel and difficult problems. Confronting rapid and fundamental changes in the telephone industry as a result of competition and fast moving technology, the FCC acted for the most part with flexibility and care. The Commission's work fell short of the ideal at several turns but our review does not and cannot require perfection. (Citation omitted); Voltaire, Dictionnaire Philosophique (Dramatic art) (1794) "Le mieux est l'ennemi du bien" ...The best is the enemy of the good).

"We do not find unreasoned the Commissions' determination that, to the extent practical, telephone prices should be based upon the true cost characteristics of the telephone company plant. (Citation omitted) Nor, with limited exceptions, can we quarrel with the FCC's exercise of judgement in deriving workable formulas, estimating numbers that cannot be mathematically proved, and making equitable assessments of the speed with which changes should be introduced".

"Further refinements to the FCC's plan could be debated endlessly. However, the Commission has reached a point in its deliberations where 'a

month of experience will be worth a year of hearings". (Citation omitted) The FCC has not achieved a plan of pristine quality. But in the words of Voltaire: Perfection is attained by slow degrees; it requires the hand of time'. (Citation omitted)

I respectively urge the Subcommittee to heed the wisdom of these words, and not seek by legislation to reverse any part of the FCC's Access Charge Plan now in effect. Thank you very much.

Joe B. Gibson

President

United Telephone Company of Texas

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JOINTLY USED, OR COMMON, TELEPHONE FACILITIES

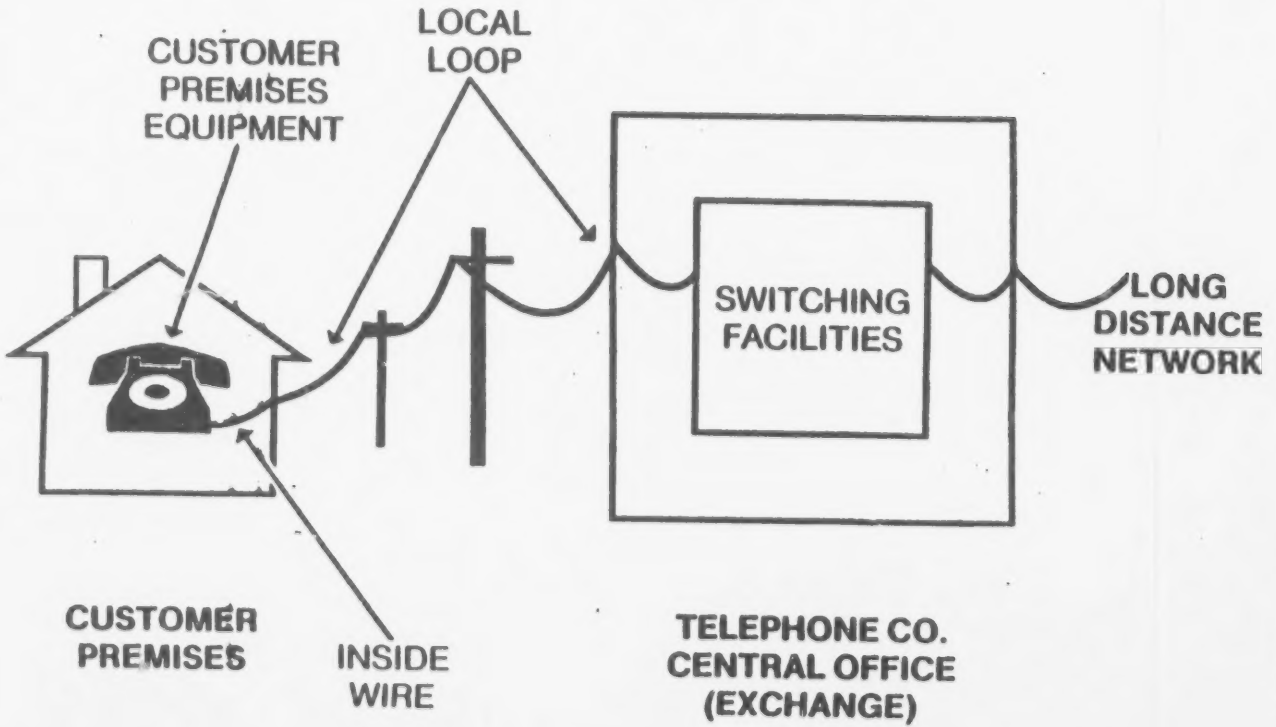

EXHIBIT A

Exhibit B

UNITED OF TEXAS, CONSOLIDATED

KEY SYSTEM ACCOUNTS

1.	Accounts	2032
2.	Lines	4875
3.	Lines/Accounts	2.4
4.	Long Distance Revenues/Month	$358,751
5.	Long Distance Revenues/Account	$ 176.55
6.	Recurring Revenues/Month (Lines, Equipment, Network Service)	$227,527
7.	Recurring Revenue/Account	$ 111.97
8.	Directory Advertising Revenues/Month	$ 44,358
9.	Directory Advertising/Account	$ 21.83
10.	Total Revenue/Month	$630,636
11.	Total Revenue/Account/Month	$ 310.35

Mr. SKELTON. Congressman Stenholm.

Mr. STENHOLM. Mr. Gibson, do you believe that these access charges or end user charges threaten universal telephone service in rural areas?

Mr. GIBSON. I think there are some significant problems. NTCA, who Mr. Farmer represents, is working at both the national and State level, in trying to resolve some of the knotty issues. I think the issues are greater in the low income households and in the low density areas where the nontraffic sensitive costs are quite high.

The FCC plan does include, however, a cap on what would be charged or what would be passed onto the end user, and that cap is about 200 percent of the average nationwide access charge, and quite frankly I do not think that represents a significant threat. I would volunteer, for example, that our average residential customer today is paying about $8 for local service. That's the average local telephone bill. Since 1977, the average local telephone bill in our company has gone up 5 cents.

I wish I could tell you that's because we have been efficient, and we have made great improvements, but a great deal of that is simply the toll subsidy.

Mr. STENHOLM. You mentioned in your testimony on page 10 in the words of the FCC, "bypass is an actual threat and present danger."

You were a little stronger in your own comments when you spoke that it was. Do you have evidence in your own company of the significance of bypass and what it has meant to you or what you fear that it will mean to you and your company?

Mr. GIBSON. In our own company, as I explained earlier, we're highly rural. We don't have a lot of large companies. The best example I can give to you would be at least one industry in Palestine and one in Athens that make extensive use of the foreign exchange service, which I suspect provides them access to alternative long distance carriers and to the Metroplex.

Now, some of the FCC proposals would address FX service and would impose much higher charges on FX. I think it would tend to drive some of those companies away from FX. But that's a form of bypass in that they have not been using the local switched network for completing their calls.

Mr. STENHOLM. Mr. Farmer, would you answer both of those questions?

Mr. FARMER. We won't have a problem with bypass in the rurals we serve, in areas where there is nothing out there. What we're about to see is toll deaveraging on these short hauls, and low density routes. Of course, the big companies, MCI, Sprint, they like Abilene and Fort Worth and areas like that.

I think the FCC is going to have to come out with something that guarantees a carrier of last resort for some of our areas. Of course, MCI or Sprint are not going to pick up small communities and towns we serve with less than 100 people in them. See what I mean.

On the access charges, the way I understand it, if FCC carries through with it, our rates within the 1990's could be as high as $30 a month just for local rates, and we have many people out in our areas that have got an income of $350 per month. You tack $30 for a telephone bill on top of the high electric bill and gas, they are going to have to drop something, and the telephone is going to be one of the first things to go, we think.

The more dropoffs, the higher the ones that stay on are going to have to pay, in monthly charges.

Mr. STENHOLM. Mr. Gibson?

Mr. GIBSON. But, the same phenomena occurs when we begin to talk about bypass. Currently, 15 cents per minute in the interstate jurisdiction is added on to any long-distance call to take care of the nontraffic sensitive plant costs that both Mr. Farmer and I have.

As bypass occurs, and that mandatory pool that we participate in experiences a shortfall, and it will as the calling volumes go down and people bypass, then those cents per minute are going to have to be increased just to stay even. They might go to 20 cents or 25 cents, and it's going to be a vicious spiral.

As they go up, it will force more and more people off. The economic crossover for them will be reached, where a given customer or a given heavy long distance user will throw up his hands and say no more. I'll build my own network to the point where I can avoid having to go through the local telephone company.

Now, that 15 cents a minute, is what's flowing to Mr. Farmer and myself. The Federal Government is the biggest bypasser we've got. In the State of Texas, the State is right up among the top.

Mr. STENHOLM. Mr. Gibson, do you support the concept of universal telephone service?

Mr. GIBSON. Absolutely. Absolutely.

Mr. STENHOLM. Do you believe——

Mr. GIBSON. It would be my objective to ensure that we don't have a single customer drop off the network because of economic hardship, and I submit to you the telephone service at $8 a month is the best bargain in the world. It's the only service or product over the last 20 years as compared to inflation that has actually cost less today than it did 20 years ago.

Mr. STENHOLM. Mr. Brown, please provide us with a little amplification on how all of this affects you and your business. What's happened to you today?

Mr. BROWN. Well, I think we're talking about different areas of confusion and different areas of responsibility, and so forth.

Now, my comments are primarily directed at distribution costs of a program service, and the use of telephone lines 100 percent for that purpose, for distributing that program service.

There are other proposals that will affect us some, but I don't think they are going to be as punitive or as difficult to handle as the one that I addressed here. If we serve your office with our program service, a significant portion of the amount we would charge you will be passed through money for us to pay for the telephone private line service that we have to have in order to provide you with the signal on your premise.

The proposals as I said in here are to increase that private line charge by 500 to 10,000 percent. We couldn't last till breakfast with that sort of thing, and it's hard to understand, Charles, because—and I don't know whether these gentlemen have the problem or not, but I feel like you do serve some—maybe Tyler, for instance, Kendall and Tyler—but, we don't have a viable alternative.

Now, they are talking about bypass and I'm sitting over here drooling, but I don't know of a viable alternative for our problem. I don't know whether that answers your question or not.

Mr. STENHOLM. Thank you, Mr. Chairman.

Mr. SKELTON. Congressman Vandergriff.

Mr. VANDERGRIFF. Time is fleeting, so just one question for you gentlemen, Mr. Farmer, Mr. Gibson. How do you feel about the exemption for single line businesses?

Mr. SKELTON. Which, by the way, expires next year.

Mr. GIBSON. Well, it is a whole process which started early last year, has been one change after another, and that was one of the compromises that was made along the way in order to get something done. Bell had a real problem in meeting the court order requirements, among other things. We can live with it, but we certainly would not like to see it delayed. It would fall into the category similar to a residential access line come June 1, 1985.

Mr. FARMER. Well, I think it was great, and I hope that we can keep it from being implemented in June 1985, on residents and small businesses. I wish we could get the 6 bucks off of what's already been put on there. It was amazing to me when the FCC, back

on May 25, implemented a $6 access charge. I didn't see not one headline, you know, about that. FCC came up with a 6.1 reduction in tolls. If that would have been Mr. Gibson or I went down to the FCC and applied for a $6 a month rate increase for line, it would have been on the headlines of the Abilene Reporter News in bold letters, but they really snuck that one by.

Mr. SKELTON. When people get their bills, which they are doing now——

Mr. FARMER. Of course, I've been warning everybody for 1½ years, and I'm sure Mr. Stenholm can verify that because he got lots of cards and letters from my subscribers, and we're hoping we can eliminate the access charge. I think it's going to drive a lot of our subscribers off the network.

Mr. SKELTON. What we have, we have until June 1985, a $6 access charge on the single business, on the single homes. You have reduced rates on your large corporations for fear of bypass competition, so that leaves the small business person with multiple lines paying $6 per line. That's a real concern.

Mr. Gibson, my one question to you, sir, is, your closing statement a few moments ago, sir, something to the effect that you felt that the small businesses would be the beneficiaries of the changes in the telephone system. For the life of me, I can't see my way clear to come to the same conclusion as you. I don't want to see the access charges eating up people like Mr. Brown, small CPA firms that have four or five lines going into them, grain elevators that have three or four lines going into them, and they are getting stuck with a multiple $6 access charge.

Can you enlighten me on what you mean by that, sir? Am I wrong?

Mr. GIBSON. I don't know whether you're wrong or not. I can tell you what an analysis of the profile of our customers showed, which I tried to summarize quickly.

Mr. SKELTON. Excuse me. Small businesses have been singled out and stuck with the $6 access charge on their local lines. How in the world can the system that brings this about cause them to be the beneficiary?

Mr. GIBSON. Well, No. 1, they will be guaranteed in the long run that they will have local telephone service. Two, if you have the 6 percent decrease in long-distance rates or the 15 percent which is proposed on June 1, 1985, and Commissioner Fowler says AT&T is committed to an additional 15-percent discount as other access charges are implemented beyond 1985.

Our profile of small business shows that they make a significant amount of long-distance calls. Now, you do have a phenomenon within the State of Texas.

Mr. SKELTON. You have a phenomenon within many small businesses that make no long-distance calls period or very few, 2 or 3 a month, and they are paying the same as the small business that has multiple lines that makes all their calls long distance.

How do you equalize that inequity?

Mr. GIBSON. I don't equalize it. Someone has to decide whether or not it's going to be the social and political policy of the country that we're going to continue to subsidize certain classes of subscribers.

Now, we were criticized in hearings held by Congressman Van Deelin and Congressman Worth, and we were criticized severely because they said we were implementing social policy due to this built in subsidy. We were flowing money from the State to the Feds and back, and we shouldn't be involved in social policies.

Well, I'll accept that. I did feel at the time the system worked. The total system worked well and the subsidies appeared to be beneficial to everyone. When we introduced competitors into the segment of the market, the whole equation changed.

Mr. SKELTON. That's what you have.

Mr. GIBSON. You've absolutely got that. Now, if you want to continue to subsidize a group of people, I would suggest that they be targeted and that Congress face up to the problem of how you subsidize them like you subsidize welfare and other things. Now, the phenomenon that you mentioned, how can business incur the costs, there is nothing new here. Business is currently paying about two and a half times the rate for a local access line. That has no relationship to the cost of that local access line. Now, that's been a political decision over the years. Basically, it's been made in the regulatory process.

It may sound crude to you, but the business people represent a smaller block of voters and it's been typical to say sock it to business. So, our business customers right now are paying two to two and a half times for a connection to our network and I would guess that our cost would reflect that it's cheaper to serve a business than it is somebody out in the country.

Mr. SKELTON. Ms. Pulley has a question.

Ms. PULLEY. If you can explain just a little more the two to two and a half times the small business is paying for access to the local system, right?

Mr. GIBSON. Yes.

Ms. PULLEY. We're not talking about long distance?

Mr. GIBSON. Their basic local rate for a line or a trunk connected to our office is about two and a half times that of a residential subscriber.

Ms. PULLEY. OK.

Mr. GIBSON. That goes back to the value of service——

Mr. SKELTON. What's that in dollars?

Mr. GIBSON. Pricing concept.

Mr. SKELTON. What's that in dollars?

Mr. GIBSON. In our case, it's a difference of around $8 and $17 and $18. We're a little less than two and a half times, but I understand that the nationwide average is about two and a half times.

Mr. SKELTON. Mr. Gibson, thank you. Any further questions?

[No response.]

Gentlemen, thank you. It's a tough subject, and we didn't know you were going to be testifying in two hearings, not one, but your testimony will appear in our hearing and your testimony will also appear in the task force testimony that will be printed as a result of Congressman Wyden's chairmanship.

Thank you all very much.

We have one last witness, from the Small Business Institute, Mr. Don Altman.

Mr. Altman.

TESTIMONY OF DON ALTMAN, DIRECTOR, SMALL BUSINESS INSTITUTE

Mr. ALTMAN. Thank you.

I appreciate the opportunity, Mr. Chairman, and Congressman Stenholm and Congressman Vandergriff, to be here. I have been listening to some of the comments, and I'd like to tell you about a program that is positive, I think—I'd like to tell you about the Small Business Institute. I believe you gentlemen have a statement that I have prepared, and, so, I won't read this verbatim and go through it.

First, I would just like to explain since there may be a question about what the lady a moment ago mentioned—the small business development center, the SBDC's that are coming up.

The Small Business Institute is actually an older concept that was started back in 1972–73, and in the States where the SBDC's are functioning already, in some cases, the SBI is part of the SBDC. The SBDC is a more far reaching, broader type of program.

The Small Business Institute is simply an arrangement between the Small Business Administration and the world of academia, the schools of business, to provide management assistance counseling and consulting to those small businesses that, in many cases, cannot afford to hire professional consultants.

I'm a professor out at Abilene Christian University, and I have run the Small Business Institute since its inception in 1972, so we have been charter members of this program.

As an educator, I'm interested in bridging the gap between the classroom and the world of business, and this program has been highly successful in introducing students in the college of business to the real world of business, and kind of bridging the gap between practicality and textbook theory.

I know you gentlemen are probably aware, that during the past 2 or 3 years, there has been just a surge of interest in entrepreneurship throughout this country. There have been more and more people willing to get into small business. We think the SBI programs with more than 450 schools, have at least been a contributing factor to this, and I'm convinced, as I know you probably are also, that small business really is the backbone of our economy.

So, I think this is a very positive thing. Now, the problem with this is that the Small Business Institute program does cost money, and at the schools of business, we don't have the money to provide for the student expenses in going out and consulting with these businesses.

The SBA initially authorized $250 for each completed case that a school worked within certain limits. There is a contract that's given to each school that participates in the program. There are limits established. This $250 a case prevailed until last year when they increased the amount to $400 a case. However, the total budget did not go up. Consequently, we are working fewer cases. We are able to cover our expenses better, but we're working fewer cases.

So, I would like to request that you gentlemen give favorable consideration to supporting the SBI program budget, because it's one of those programs where everybody wins. As I've told you in

the written statement, I believe in free enterprise, and I do not believe in the Government guaranteeing anyone a profit or supporting all of the businesses and guaranteeing against failure.

When you've got a program as good as this one is, where the communities win, the small business people who participate in the program win, the students certainly win by it, it seems to me like this is one of those programs that should be supported.

[Mr. Altman's prepared statement follows:]

PREPARED STATEMENT OF DON ALTMAN, DIRECTOR, SMALL BUSINESS INSTITUTE

The Small Business Institute (SBI) links local small businesses to the resources and management expertise of college and university schools of business. The SBI provides confidential and professional management assistance at no cost to the small businesses. Through the SBI program, seniors or graduate business students are assigned to work on a case under the supervision of a college faculty member. The project is closely associated with efforts of the U.S. Small Business Administration.

The idea of establishing a mutually rewarding relationship between colleges and their business communities was apparently conceived by business faculty at Texas Tech University. In any event, those faculty members persuaded the Small Business Administration to financially support and co-sponsor the SBI commencing with the 1972/73 school year. In the twelve years of its existence, the SBI has grown from initially less than 50 participating schools to currently more than 450 schools nationwide. More than 8500 businesses received assistance through the SBI during the last school year. Abilene Christian University, a charter member of the SBI, has worked with approximately 300 businesses in the Abilene area.

Obviously, both owners of small businesses and students benefit from the program. Students receive an opportunity to put their classroom knowledge and skills to work, while businesses get the kind of quality consulting services they might not otherwise be able to afford. An additional benefit, which in the beginning was largely overlooked, is that

thousands of young men and women have been imbued with the excitement and challenge of owning their own businesses. I am convinced that the SBI has been a contributing factor to the regeneration of the entrepreneurial spirit in the United States.

SBI student expenses are paid by the colleges and universities, using funds provided by contract with the Small Business Administration and funds donated by other organizations interested in assisting small businesses. The SBI project costs the small business owner nothing but the time and effort involved in sharing information with the SBI student team and the faculty member involved.

The expenses involved are occasionally quite heavy. At Abilene Christian we have worked with businesses as far away as Snyder, approximately 80 miles. Normally, a case requires four or five trips by the SBI team to the business so expenses can rise rather quickly. As a general rule we try to work with businesses which are located within a 50-mile radius of Abilene.

A business does not need to have a loan from the Small Business Administration to qualify for consulting services from the SBI. Requests for assistance can be made through the District Small Business Administration office or directly to the participating school. Upon acceptance of the request, the SBI director assigns the students to consult on the case and they meet with the owner. After the students and owner(s) have agreed on specific needs and services--for example, marketing surveys, inventory control systems, or cash flow analysis--the students then proceed with specific tasks. Upon completion, the team prepares a comprehensive written report, which includes their recommendations, and presents it to the owner. As with any consultant, the owner may accept, reject, or modify the SBI team's suggestions.

The reaction from small business owners who have participated in the SBI generally have been very positive. It is extremely difficult, if not impossible, to accurately assess the benefits of the program because of the many intangibles involved. I believe, however, that it is a program which should be expanded. From the program's inception through the 1982/83 school year participating schools received $250.00 per completed case. In the 1983/84 school year the amount per case was raised to $400.00 but the budget total remained about the same. Consequently, the number of cases contracted by the Small Business Administration was reduced resulting in fewer businesses receiving assistance.

I respectfully request your assistance in supporting the SBI program, particularly with respect to its funding by the federal government. While I am a firm believer in free enterprise and believe that the "right to fail" is as important as the "right to succeed," I am also convinced that a program such as the SBI where everyone wins should be continued and even expanded. The students and small business owners certainly benefit and the communities and country in which we all live are better off as a result of the SBI.

Mr. SKELTON. Thank you so much.

Mr. Stenholm?

Mr. STENHOLM. Mr. Chairman, no question. I would just thank Mr. Altman for participating. I've come to be aware of the program and have had the privilege on just a couple of occasions to observe an interchange between a student and the small business community, and I believe there is a lot of merit in the concept.

As I say no questions. I just thank Mr. Altman for testifying and making this a part of the record so that as we deliberate, we will be aware of yet another aspect of small business, SBA and intertwining as we deliberate in the future.

Mr. SKELTON. Congressman Vandergriff?

Mr. VANDERGRIFF. I would echo Congressman Stenholm's sentiments. I'm an enthusiastic supporter, sir. I'm very excited about the new high-tech small business development centers at the University of Texas at Arlington. They specialize in the high-tech area. They might even be of some benefit to the business firms here in your region where your institute would not necessarily be that expert in relating to the high-tech field.

Mr. ALTMAN. No, we would not be.

Mr. VANDERGRIFF. But, in any event, you can count on me for very enthusiastic support. I'd like to see the program expanded.

Mr. ALTMAN. You have a very successful SBI at the University of Texas at Arlington, as you well know.

Mr. VANDERGRIFF. That's correct. Yes, sir.

Mr. ALTMAN. One of the problems that we have occasionally is convincing the small businessperson that we in academia can be of assistance. We have a credibility gap. Just recently I was reading that when the National Federation of Independent Businesses did a survey of small business owners, college professors, believability or credibility with the small business community ranked down near the bottom among all the categories of people they had listed.

In fact, as I recall, we finished in about a dead heat with Congress, with Members of Congress, as far as the credibility was concerned, and one of the things that we hope to do, if we had additional funds available to us, is to promote this program, to make more people aware of it.

The media have helped us, but we need a continuing promotional effort to let the people throughout this area know that the service is available. One of the things that small businesses have a problem with is knowing where to go to get help and information, and this is one of the things we'd like to do, is to let them know about this.

Thank you very much.

Mr. SKELTON. Thank you. Wonder of wonders. We finished a minute or so ahead of time.

Mr. VANDERGRIFF. Could I have one of those minutes, Mr. Chairman?

Mr. SKELTON. Yes, you may have one of those minutes.

Mr. VANDERGRIFF. All right. I don't want to embarrass our host unduly. We have long felt that Congressman Stenholm had a knowledge of west Texas like few other men. He knows it like the back of his hand seemingly as he represents it so well in Congress.

Therefore, it was somewhat startling to me, Mr. Chairman, yesterday evening, when you asked him the name of the mountain that we could see off to the west as we drove through the community. I remember how surprised you were when Congressman Stenholm, after a moment of hesitation, said the name of the mountain was "The Mountain."

I must say I was taken aback by this, too. It's rather surprising to me, that we from north central Texas, must come and advise Congressman Stenholm of the name of the mountain, but we want him to be better informed. We don't want you to go back to Missouri without knowing that, after my staff has done considerable research, we can tell you that the name of the mountain is "Castle Peak." I'd also like to give you this little brochure and if you don't mind, would you pass this over to Congressman Stenholm? He gave the impression he was a tourist in the area last night as well.

I may have abused that minute, it may have stretched out to a minute and a half, but hopefully it will serve some useful purpose for the Congressman in the future.

Mr. SKELTON. Let the record show that Castle Peak is now part of the record here. For rebuttal, we will allow Congressman Stenholm to add to that.

Mr. STENHOLM. Well, let the record also show that the president of the Abilene Chamber of Commerce, Mr. Dick Bolden, incorrectly informed us last night, the first time I took the lid off of this, that that was Cedar Gap. So, all I can say is I appreciate, Tom, very

much your setting this record straight. That's a very important aspect.

Mr. SKELTON. I want to say a special thanks to Congressman Stenholm, who did a great deal of work, Congressman Vandergriff, in the hearing in Dallas, who did a great deal of work, and their very, very efficient staffs. You see us asking the questions and read our names in the papers and hear us on radio, and once in awhile see us on television, and we give the profound answers to the television interviewers, but those that really put the untold hours in are the staff members that lined this up.

A special thanks to Congressman Stenholm's staff, and a special thanks to Congressman Vandergriff's staff, and I am very, very grateful.

Ladies and gentlemen, thank you for your hospitality, for your time. This is an example of how democracy works. We appreciate your comments. What has been learned here and what has been transcribed here will become not only part of the record, but will be shared with the rest of our subcommittee as well as the full Small Business Committee.

The comments you made are terribly important to you. I think you will see pieces of legislation, letters of inquiry, and debate on the House floor and within the committee sparked by what we have heard today and what we have heard yesterday.

Thank you again so much for your hospitality. This hearing is adjourned.

[Whereupon, at 2:45 p.m., the subcommittee adjourned, to reconvene subject to call of the Chair.]

APPENDIX

Appendix A.—Prepared Statement of Danny Kellar, General Manager, Coleman County Telephone Co-Operative, Inc.

My name is Danny Kellar; General Manager of Coleman County Telephone Cooperative, Inc. located in Santa Anna; Texas; Coleman County Telephone Cooperative; Inc. provides telephone service to parts of three counties: Coleman; Brown and Concho; serving 1,743 members.

As you can tell; we serve the rural area and up to this point; multi-line access charges really haven't affected us. We serve one hundred and fifty small businesses of which sixteen are multi-line users. Of these sixteen, only five businesses have more than two lines. The point I am trying to emphasize is that even though our customers have not really felt the impact of access charges, we foresee definite problems in the future. Should the F.C.C. reverse itself and impose access charges on all users, the results to Coleman County Telephone Cooperative, Inc. could be disastrous, due to the fact that thirty to sixty percent of our customers are either on fixed incomes or below the national wage average.

Not only are our members being affected by deregulation, our company is facing drastic change, causing additional personnel and paper work. This in turn increases our expenditures and the need to seek a rate increase.

Being a telephone company, we are obligated to provide service to any customer who requests it; an obligation that goes hand in hand with the right to be the sole provider. More and more companies want to resell local and long distance telephone service. Developers; universities, hospitals, corporations and government agencies are putting in systems to resell local and long distance service. As the authorized sole supplier in an area; we are charged with the obligation of providing exchange service to everyone on a timely basis, anywhere in our certified area, but without receiving

the pro-rata share of the revenue which should be based on our investment. The other common carrier, in my opinion, should operate in our environment and share their revenues instead of passing the cost of the local loop back to the customer in the form of "Access Charges".

A better system could be designed; for example, the system developed for Texas. The Texas IntraLata Toll Pool could be implemented on a national level. (For additional information, please contact our State Organization.)

Being restricted by our service area, we can't pick and choose our customers as can the would be "Long Distance Telephone Companies" who intend to serve the most lucrative customers.

As stated earlier in this testimony, it is our obligation to provide the local loop, thus enabling the other Common Carriers the ability to complete the calls. Therefore a profit sharing relationship would be more equitable and feasible.

We greatly appreciate the opportunity to air our feelings and look forward to working with the Committee in the future.

Sincerely,

Danny Kellar

Appendix B.—Prepared Statement of Alvin M. Fuhrman, President, Muenster Telephone Corp.

I appreciate the opportunity to address this Subcommittee of the Special Small Business Committee and to relay to you some unique problems that I as a small business man am presently encountering. My name is Alvin M. Fuhrman. I am President of Muenster Telephone Corporation. We provide service in Muenster and Valley View, Texas, both in Congressman Stenholm's district. My address is P. O. Box 587, Muenster, Texas 76252.

For many years small telephone companies were concerned with providing the best quality service possible at the lowest possible rates to our customers. We recognized that we were monopolies serving our area subject to regulation by the Federal Communications Commission and by the State Public Utility Commission.

At this time the telephone industry is undergoing the most dramatic change ever experienced over the last 100 years. The breakup of the AT&T system, the loss of toll revenue settlements from long distance services, the repricing of long distance service, the imposition of access charges on providers of long distance service, the shift of non-traffic sensitive cost away

from long distance users, and the introduction of competition are all greatly effecting a small telephone company at such a fast pace that I find it difficult to stay abreast with the latest changes.

I believe that a small telephone company should have the latest, up-to-date technology to meet the demands for good quality service and the demands from the introduction of competition. The small telephone company like Muenster is unable to participate in the proceedings concerning devistitute of AT&T in the Federal Courts or before proceedings by the Federal Communications Commission. We look to you as our opportunity to express our problems and voice our concerns.

One of the primary problems I am encountering at both the Federal Communication Commission level and with the State Public Utility Commission is the old regulatory concept of long service lives and low depreciation rates which force us to maintain out-of-date or obsolete equipment on our systems and prevent us from up-grading our systems with the latest technology. I have found out that the new companies providing long distance telephone service are virtually deregulated at both the Federal and State level and can offer new service offerings, change rates and enter or leave new service markets without regulatory control. Muenster Telephone Company, on the other hand, is

prevented from meeting this type competition by requirements of endless hearings that last in excess of a year concerning new service offerings, rate case that last seven to eight months and the usual red tape that prohibit us the same flexibility afforded our competitors.

Muenster Telephone Company believes that it can provide good quality telephone service using up-to-date equipment to meet these changes in the telephone industry. It is in the best interest of our customers that we remain a viable telephone company able to meet these challenges at both the Federal and State level.

I trust that when you go back to Congress and are subjected to the intense lobbying efforts on behalf of AT&T, MCI and the other long distance telephone service providers, you will remember my comments and problems. I want to keep telephone rates affordable to our customers, I want to provide good service and take advantage of the lastest inovations in technology, but I need your help.

As stated by Jordan J. Baruch recently, "The Cultures of Science and Technology are thus almost opposites - a fact we either ignore or deny when we establish agencies under the rubric of 'science and technology.' If we are to make and implement sound public policy regarding science and technology, we must understand these differences and capitalize on them rather than deny them. Indeed the linking of science and technology that we do routinely may be the first hurdle of denial that we must overcome."

Thank you. Do you have any questions?

APPENDIX C.—PREPARED STATEMENT OF ROBERT C. JOHNSON, EXECUTIVE VICE PRESIDENT, CALIFORNIA PHARMACISTS ASSOCIATION

California Pharmacists Association
1112 I Street Sacramento, California 95814 (916) 444-7811
Robert C. Johnson Executive Vice President

July 23, 1984

The Honorable Charles Stenholm
United States House of Representatives
Longworth House Office Building
Room 1232
Washington, D.C. 20515

Dear Congressman Stenholm:

John Carson and Luther Parker, President and Executive Director, respectively, of the Texas Pharmaceutical Association, have asked me to provide you with additional information on the problems created for pharmacists by the price differentials used in the drug industry.

The disparity between prices charged by drug manufacturers to institutions and clinics, on the one hand, and community pharmacies on the other, has no basis in reason or equity. We know, for example, that Ortho, who according to statistics provided us by the California State Office of Family Planning, supplies 80% of the contraceptive pills to family planning clinics throughout the country, typically charges such clinics 55 to 65 cents per cycle. The standard price of a cycle of the identical product to a community pharmacy is between $8.00 and $9.00. In California, there is no restriction on the patients that these largely government-funded clinics serve. Obviously, given this price differential, there is no way the independent pharmacies can compete.

A glaring example of independent pharmacies being shut out of competition by grossly disparate prices is seen in the home health care market. There are essentially five manufacturers of the parenteral solutions and "high tech" products used in home health care, four of which are themselves engaged in providing home health care at the retail level. (One of these four, Johnson & Johnson, has recently announced its intent to pull out of the retail operation.) As evidenced by their own promotional material, these manufacturers offer seductive financial incentives to hospitals, including (in some instances) free product, in order to woo physicians and subsequently patients to continued use of its line.

Member pharmacists have reported to us that the home health care manufacturers/retailers foreclose any competition from independent pharmacies by offering the product which they give gratis to the hospitals at prices of $58 and $60 a unit to the would-be competitor pharmacy. Again, there is simply no way that independent pharmacies can effectively compete.

Protected by the Section 13c exemption of the Robinson-Patman Act (known as the Nonprofit Institutions Act), manufacturers offer drug products to hospitals, clinics and other institutions at substantially lower prices than they offer to independent pharmacies. That practice is universal and axiomatic within the pharmaceutical industry.

However meritoriosly conceived the Nonprofit Institutions Act may have been, we believe, it has long since lost its reason for being. The savings realized by the institution is hardly passed on to the consumer. Any inpatient who has examined the ancillary services billed by his hospital knows he is characteristically charged many times market price for each individual aspirin tablet and cotton-tip swab. The community pharmacy and the patients it serves meanwhile subsidize the hospital through the higher prices pharmacies must pay to the manufacturers.

In the last six weeks, our association has received reports of at least six hospitals (or hospital groups) around the state that are operating outside the Section 13c exemption, as defined by the U.S. Supreme Court in Abbott Laboratories v. Portland Retail Druggists Association, by selling drugs to outpatients through their retail pharmacies or through their home health care departments in competition with community pharmacies. Yet our antitrust counsel, nationally recognized in this field, advised us that a plantiff only has a cause of action against these hospitals if he can show direct monetary injury. No class action is permitted, and the plantiff's burden of proof is almost insurmountable.

Furthermore, our own state government has just signed contracts with three drug manufacturers to purchase contraceptive drugs and devices at grossly preferential prices like those I have described in the second paragraph of this letter. While we believe that the actions of the state contractors and our Department of Health Services are patently contrary to the decisions in Abbott Laboratories v. Portland Retail Druggist Association and Jefferson County Pharmaceutical Association v. Abbott Laboratories, our attempts to stop this program have been futile.

I endorse the appeal made to you by Texas pharmacist Lex Shelby at the hearing of the house subcommittee on Energy Environment and Safety Issues Effecting Small Business in Abilene on July 11, for a congressional mandate to the FTC and Justice Department to enforce the Robinson-Patman Act. It is our informed belief that at least three members of the Commission believe the act should be ignored and that the Justice Department has no inclination to bring the enforcement actions that would assist pharmacists.

Although we support Mr. Shelby's endorsement of H.R. 5237 (Markey), which would prohibit the sale of goods below cost in an effort to injure, destroy or prevent competition, we do not see such legislation as a solution. California now has state law to the same effect, but again, a necessary element of proof is intent to injure, destroy or prevent competition. Our case law has so ameliorated the effect of the statute that a competitor's testimony that he was only intending to build up his own business (not to destroy someone elses), is sufficient to defeat the cause of action. It is usually impossible for the complainent to meet this burden of proof.

I would propose as the only viable solution to the anticompetitive pricing practices of the drug manufacturers legislation that would prohibit these pricing differentials altogether. This is not to preclude volume discounts or other reasonable price differentials which are consistent with good marketing practices.

The California Pharmacists Association anticipates holding a hearing on this subject before the State Assembly sometime this fall. We have begun to compile data and other substantive evidence to support our position. I would be most happy to share this with you and hope that it will assist you in working for some much needed relief for the independent pharmacist. We applaud your work in that direction.

Sincerely,

Robert C. Johnson
Executive Vice-President

RCJ:saf

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